

7638
MAR 13 1968

F 2302

San Francisco Law Library

436 CITY HALL


No. *188192*

EXTRACT FROM RULES

Rule 1a. Books and other legal material may be borrowed from the San Francisco Law Library for use within the City and County of San Francisco, for the periods of time and on the conditions hereinafter provided, by the judges of all courts situated within the City and County, by Municipal, State and Federal officers, and any member of the State Bar in good standing and practicing law in the City and County of San Francisco. Each book or other item so borrowed shall be returned within five days or such shorter period as the Librarian shall require for books of special character, including books constantly in use, or of unusual value. The Librarian may, in his discretion, grant such renewals and extensions of time for the return of books as he may deem proper under the particular circumstances and to the best interests of the Library and its patrons. Books shall not be borrowed or withdrawn from the Library by the general public or by law students except in unusual cases of extenuating circumstances and within the discretion of the Librarian.

Rule 2a. No book or other item shall be removed or withdrawn from the Library by anyone for any purpose without first giving written receipt in such form as shall be prescribed and furnished for the purpose, failure of which shall be ground for suspension or denial of the privilege of the Library.

Rule 5a. No book or other material in the Library shall have the leaves folded down, or be marked, dog-eared, or otherwise soiled, defaced or injured, and any person violating this provision shall be liable for a sum not exceeding treble the cost of replacement of the book or other material so treated and may be denied the further privilege of the Library.



Digitized by the Internet Archive
in 2010 with funding from
Public.Resource.Org and Law.Gov

V. 3-5-67

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

METLOX MANUFACTURING COMPANY, }

Petitioner, }

vs. }

No. 20,299 ✓

NATIONAL LABOR RELATIONS BOARD, }

Respondent. }

On Petition to Set Aside Decision and
Order of the National Labor Relations Board

PETITIONER'S OPENING BRIEF

FILED

AUG 15 1966

WM. B. LUCK, CLERK

SHEPPARD, MULLIN, RICHTER & HAMPTON

458 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90013

TOPICAL INDEX

Page

I

Jurisdiction----- 1

II

1. Concise statement of the case ----- 2

2. Questions involved ----- 10

III

Specification of errors ----- 11

IV

Since the Company agreed to an unrestricted
audit of its books, it was not a refusal
to bargain for the Company to insist upon
the confidentiality of information which
the Union wanted so as to pass upon the
efficiency of the management and so as to
determine whether there were any "deadheads"
on the office payroll ----- 12

V

The strike was an economic strike, and was
not caused by any unfair labor practice
by the Company ----- 16

VI

The Company did not violate the October 29,
1963 settlement agreement ----- 19

VII

Conclusion ----- 20

TABLE OF AUTHORITIES CITED

<u>Cases</u>	<u>Page</u>
Albany Garage, Inc., 126 NLRB No. 52, 45 LRRM 1329 (1960) -----	14
Fruit & Vegetable Packers v. NLRB, 316 F.2d 389 (D.C. Cir. 1963) -----	12, 13
NLRB v. Barrett Co., 135 F.2d 959 (7 Cir. 1943)-	16
NLRB v. Jacobs Mfg. Co., 196 F.2d 680 (2 Cir. 1952) -----	14
NLRB v. Remington Rand, Inc., 94 F.2d 862 (2 Cir. 1938) -----	17
NLRB v. Scott & Scott, 245 F.2d 926 (9 Cir. 1957) -----	17
NLRB v. Stackpole Carbon Co., 105 F.2d 167 (3 Cir. 1939) -----	16
NLRB v. Swinerton, 202 F.2d 511 (9 Cir. 1953) -----	16
NLRB v. Truitt Manufacturing Co., 351 U.S. 149 (1956) -----	12
NLRB v. Western Wirebound Box Co., 356 F.2d 88 (9 Cir. 1966) -----	15
Tennessee Chair Co., 126 NLRB No. 160, 45 LRRM 1472 (1960) -----	14
United Fire Proof Warehouse Co. v. NLRB, 356 F.2d 494 (7 Cir. 1966) -----	15
Winter Garden Citrus Products Coop. v. NLRB, 238 F.2d 128 (5 Cir. 1956) -----	18
Yakima Frozen Foods, 130 NLRB No. 128, 47 LRRM 1472 (1961) -----	12, 13,

1 IN THE UNITED STATES COURT OF APPEALS
2 FOR THE NINTH CIRCUIT

3 METLOX MANUFACTURING COMPANY, }

4 Petitioner, }

5 v. }

No. 20,299

6 NATIONAL LABOR RELATIONS BOARD, }

7 Respondent. }

8
9 On Petition to Set Aside Decision and
10 Order of the National Labor Relations Board

11 PETITIONER'S OPENING BRIEF

12
13 I

14 JURISDICTION

15 The National Labor Relations Board issued its
16 Decision and Order herein dated July 12, 1965, finding peti-
17 tioner guilty of unfair labor practices within the meaning
18 of Sections 8(a)(1) and 8(a)(5) of the National Labor
19 Relations Act. This Court has jurisdiction to review the
20 Board's Decision and Order upon petition of Metlox
21 Manufacturing Company, a person aggrieved thereby. (29 U.S.
22 C.A. § 160(f).) Such petition was filed August 12, 1965.
23
24
25
26

1 II

2 CONCISE STATEMENT OF THE
3 CASE AND QUESTIONS INVOLVED.

4 1. Statement of the Case.

5 The Union was certified as the collective bargaining
6 representative of an appropriate unit of the Company's
7 employees on June 11, 1963. (TXD, p. 3, lines 23-39.)¹

8 On September 17, 1963, the Union filed a refusal-to-
9 bargain charge against the Company (G.C. 1(i)); this charge
10 was settled by a settlement agreement approved by the
11 Regional Director on October 29, 1963. (G.C. 5.)

12 There is no allegation in the complaint nor
13 contention by the General Counsel that any conduct of the
14 Company since the October 29, 1963 settlement agreement
15 constitutes a violation of the Act other than the Company's
16 refusal "to furnish the Union with records and other
17 probative material necessary for the Union to discharge
18 its functions as the statutory bargaining representative
19 of the employees", and that by such conduct the Company
20 refused to bargain in good faith. (TXD, p. 3, lines 25-32.)

21 The issue of whether the Company refused to
22 bargain with the Union prior to the October 29, 1963
23 settlement agreement is pertinent only if it first is held

24 _____
25 ¹"TXD" refers to the Trial Examiner's Decision,
26 adopted by the Board.

1 that the Company engaged in a refusal to bargain
2 following the settlement agreement. (TXD, p. 3,
3 lines 14-19; p. 13, lines 40-62.)

4 During the negotiations, the Union requested
5 information from the Company on a multiplicity of
6 matters: seniority, earnings of employees (including
7 piece work rates), group insurance, time studies
8 done by the Company in settling existing wage rates,
9 information about laid-off employees; all such
10 information requested by the Union was supplied by
11 the Company. (TXD, p. 3, lines 36-41.)

12 The information requested by the Union
13 and supplied by the Company included employees'
14 minimum base rates; top base rates; the Company's
15 review schedule for wage increases; existing fringe
16 benefits (holidays, shift differentials, vacations,
17 group insurance coverage); incentive rates for each
18 product manufactured, by department; payroll review
19 scales as a percent of production; group insurance
20 premium report; group life insurance policy; the
21 method by which the incentive standards were
22 established; average hourly earnings of each
23 employee; total earnings of each employee; hours
24 worked by each employee; samples of the thousands of
25 statistics in connection with incentive rates (the
26 Company offered to supply others, if the Union wished);

1 list of lay-offs, whether recalled and if not, why
2 not; group health and accident experience for 1963;
3 and standard data calculation sheets related to
4 piece rates. (Tr. p. 197, line 5 - p. 202, line 11.)

5 There is no contention that the Company was
6 other than completely cooperative in furnishing the
7 foregoing data and information requested by the Union
8 and, as noted, the Trial Examiner specifically found
9 that the Company supplied such information. (TXD,
10 p. 3, lines 36-41.)

11 The union demanded a wage increase and
12 other cost items (TXD, p. 3, line 4; G.C. 2(b),
13 p. 23, line 22 - p. 24, line 4). These were rejected
14 by the Company on the ground that the Company could
15 not afford any increase on any cost item. (TXD, p. 4,
16 lines 4-7.)

17 The Company gave the Union a detailed analysis
18 of the cost to the Company if the Union's demands were
19 met (TXD, p. 3, line 43 - p. 4, line 4; G.C. 2(b),
20 p. 24, line 5 - p. 29, line 12; Resp. 1; Resp. 2) and
21 also gave the Union the Company's profit and loss
22 statements for 1961, 1962 and 1963. (TXD, p. 4,
23 lines 15-65; G.C. 2(d), p. 203, lines 12-23; G.C.4.)
24 The Company offered to give the Union the profit
25 and loss statements for the past 10 years (G.C. 2(c),
26 p. 114, lines 1-5; p. 117, line 20 - p. 118,

1 line 4), but the Union only wanted them for 1961, 1962 and
2 1963. (G.C. 2(c), p. 118, line 5 - p. 119, line 5.)

3 The 1961 profit and loss statement showed a profit
4 of \$29,966.26; the 1962 statement, a profit of \$5,272.43;
5 and the 1963 statement (through November 30, 1963), a loss
6 of \$4,597.00. (TXD, p. 4, line 62; G.C. 4.)

7 The annual cost of the Union's initial demands was
8 \$218,118.00 (Resp. 1); the Union never reduced its demands
9 below an annual cost of \$68,022.00. (Resp. 2.)

10 The Union wanted to examine the books of the
11 Company to see if there was "poor management", or if there
12 were any "deadheads" on the payroll, or if the assets of the
13 Company were being "bled". (TXD, p. 11, lines 30-33.)

14 At the November 29, 1963 meeting, the Union
15 complained that there must be poor management and that
16 "there are many, many persons who are working there [i.e.,
17 at the Company] that are not necessary for the Company and
18 they are having the high salaries". (G.C. 2(b), p. 47,
19 line 7 - p. 48, line 4.)

20 At the December 18, 1963 meeting, the Union said
21 it wanted the Company's books thrown open to find out "the
22 salaries paid by the Company for their top echelon, who's
23 on the payroll and why they're on", to find out "how much
24 they get paid and why they get paid, if they have any job
25 duties or if they are just on the job as deadheads" and to
26 find out "what title they [i.e., management] carry, what

1 job they do, if they are deadheads on the payroll, it's
2 just loaded up like a lot of companies do, or if they're
3 actually performing a service for the Company". (G.C. 2(c),
4 p. 93, line 26 - p. 94, line 20; p. 97, line 8 - p. 98,
5 line 2; p. 112, lines 18-25.)

6 At the February 14, 1964 meeting, the Union,
7 although acknowledging that the boss's son-in-law does a
8 "whale of a job for him", complained that there were too
9 many people employed in the office (which is not part of
10 the unit) and that there were "helpers helping helpers. I
11 want to know why in the sam hill it is". (G.C. 2(f),
12 p. 434, line 4 - p. 436, line 6.) At the same meeting,
13 the Union said it realized that the Company was in a bad
14 financial position, but wanted to find out how it got that
15 way. (G.C. 2(f), p. 441, line 24 - p. 442, line 18.)

16 At the March 13, 1964 meeting, when asked if it
17 contended that the Company's financial statements were
18 false, the Union made no such contention, but said "We
19 want information for bargaining that -- relative to where
20 the money was spent, who is loaded on the payroll, exactly
21 what went on". (G.C. 2(g), p. 502, lines 1-6.) At the
22 same meeting, the Union, acknowledging that the Company
23 "owes a tremendous amount of money", suggested that some
24 money could be saved in the main office because "we have
25 help in that front office that are running over each other"
26 and "we're making too many reports, too many breakage

1 reports, too many this and that and the other thing. . . .
2 there are duplication of reports". (C.G. 2(g), p. 579,
3 line 16 - p. 583, line 26.)

4 Even though Union representatives admitted that
5 they previously had seen the Company's figures in prior
6 years (G.C. 2(b), p. 85, lines 10-16), knew that the
7 Company was not in good financial shape (G.C. 2(f), p. 414,
8 lines 15-18; G.C. 2(f), p. 429, lines 10-15), owed a
9 "tremendous amount of money" (G.C. 2(g), p. 579, lines 16-
10 21) and did not even have any money with which to buy
11 lumber (G.C. 2(g), p. 584, line 22 - p. 585, line 3), the
12 Union's attorney insisted that a "detailed accounting" be
13 made and that "substantiating information" be furnished to
14 the Union of the following items appearing in the Company's
15 profit and loss statements (TXD, p. 5, lines 1-28):

16 Net sales - less sales discounts

17 Factory and Shipping Wages

18 Other Salaries and Wages

19 Materials, Supplies, Expenses

20 Advertising and Commissions

21 Financial Expenses, Interest, Factoring

22 Depreciation

23 Despite the Union's admissions that it had seen
24 the Company's figures in prior years and knew the Company
25 was not in good financial shape, despite that the Union did
26 not contend that the financial statements furnished by the

1 Company were false, and despite the continuous assertion
2 of the Union that it wanted the books thrown open so that
3 the Union could pass judgment on whether there were any
4 "deadheads" on the office payroll, the Company offered to
5 permit an examination of its books, subject only to the
6 conditions that (1) the examination be in the Company's
7 office (2) by a Certified Public Accountant chosen by the
8 Union and approved by the Company (3) with the cost borne
9 by the Union and (4) with the details of the Company's
10 financial records not to be disclosed to any third parties,
11 including the Union, except to advise the Union whether
12 the Company's profit and loss statements were true. (TXD,
13 p. 5, line 30 - p. 6, line 23.)

14 The Union agreed to each of the conditions,
15 except for the confidentiality of the Company's records.
16 (TXD, p. 6, lines 28-37; G.C. 3(e).)

17 Thus, the "only significant difference between
18 the Respondent [Company] and the Union is the extent to
19 which the information developed by the accountant in the
20 course of his examination of company records can be
21 disclosed to the Union". (TXD, p. 9, lines 30-34.)

22 The Company's position on the examination of
23 its books was fully set forth by February 15, 1964 (TXD,
24 p. 6, line 39 - p. 7, line 45); the charge in this case
25 was filed on March 2, 1964 (G.C. Ex. 1(a)), but the strike
26 did not occur until April 2, 1964. (TXD, p. 13,

1 lines 17-21.)

2 As to the strike, the Trial Examiner concluded
3 that it was not an economic strike, but was an unfair
4 labor practice strike caused by the Company's failure to
5 bare its books. (TXD, p. 13, lines 1-34.)

6 However, this conclusion by the Trial Examiner
7 is not supported by the testimony of the only witness who
8 testified as to the reasons for the strike. This witness
9 was Mrs. Riley, the Union's Financial Secretary, who
10 testified as a witness for the General Counsel.

11 Mrs. Riley, on direct examination, testified that
12 after (not before) the strike had occurred, the Union
13 representatives explained ex post facto to the employees
14 ("so they would know about it") why they had struck, and
15 listed the reasons as stalling tactics, refusal to bargain,
16 unfair labor practices and Mr. Shaw's complete ignoring of
17 the Union. (Tr. p. 167, lines 5-18.)

18 As to the situation before the strike, Mrs. Riley
19 testified on cross-examination that "money . . . probably
20 was the basic concern with the people" (Tr. p. 172,
21 lines 7-8) and that (Tr. p. 175, lines 8-13):

22 A: ". . . at practically every
23 meeting, Mr. Rail [the Union agent]
24 assured us that more than likely we
25 could settle this without a strike.
26 He didn't feel that it would come

1 down to the point of having a strike."

2 Q: "Did he say -- settle what,
3 did he say?"

4 A: "Basically, a good working
5 contract for the people."

6 Mrs. Riley also testified on cross-examination
7 that, as the strike date approached, the employees "pretty
8 well knew by that time in our minds" that "we were not
9 going to receive our 35 cents an hour that we asked for"
10 (Tr. p. 177, line 24 - p. 178, line 7). She also testified
11 that "at all the subsequent meetings," Mr. Rail said that
12 the matter could be settled "very easily without a strike"
13 if such requests as wages, vacation pay, holidays,
14 seniority, job security and insurance were met. (Tr. p.
15 180, lines 4-12.)

16
17 2. Questions Involved.

18 a. Was it a refusal to bargain for
19 the Company, although providing all other
20 information requested by the Union and
21 offering to permit an unrestricted audit
22 of its books, to refuse to permit all
23 the details thereof to be disclosed to
24 the Union, where the Union expressly
25 wanted the information in order to
26 pass judgment on the efficiency of

1 management and on whether there were
2 any "deadheads" on the office payroll?

3 Answer: No.

4 b. Since the employees struck to
5 obtain a good working contract, did
6 the ex post facto explanations of the
7 union representatives convert the
8 strike into an unfair labor practice
9 strike? Answer: No.

10 c. Did the Company violate the
11 October 29, 1963 settlement agreement?

12 Answer: No.

13
14 III

15 SPECIFICATION OF ERRORS

16 1. It was error for the Trial Examiner and the
17 Board to conclude that the Company did not bargain in good
18 faith (TXD, p. 12, lines 37-43; p. 14, lines 35-38);

19 2. It was error for the Trial Examiner and the
20 Board to conclude that the strike was caused by unfair
21 labor practices of the Company (TXD, p. 13, lines 29-34;
22 p. 14, lines 40-42);

23 3. It was error for the Trial Examiner and the
24 Board to conclude that the Company violated the October 29,
25 1963 settlement agreement (TXD, p. 13, lines 40-43; p. 14,
26 lines 44-46.)

1 IV

2 SINCE THE COMPANY AGREED
3 TO AN UNRESTRICTED AUDIT
4 OF ITS BOOKS, IT WAS NOT
5 A REFUSAL TO BARGAIN FOR
6 THE COMPANY TO INSIST UPON
7 THE CONFIDENTIALITY OF
8 INFORMATION WHICH THE UNION
9 WANTED SO AS TO PASS UPON
10 THE EFFICIENCY OF THE MANAGE-
11 MENT AND SO AS TO DETERMINE
12 WHETHER THERE WERE ANY
13 "DEADHEADS" ON THE OFFICE
14 PAYROLL.

15 Here, the Company supplied the Union with profit
16 and loss statements for 1961, 1962 and 1963, offered to
17 supply profit and loss statements for the past 10 years
18 (this offer was refused by the Union), and agreed to an
19 unrestricted audit of its books to substantiate the profit
20 and loss statements. This meets the test of good faith
21 bargaining in every way. (National Labor Relations Board
22 v. Truitt Manufacturing Co., 351 U.S. 149, 152-154, 100 L.
23 ed. 1027, 1032 (1956); Fruit & Vegetable Packers v. National
24 Labor Relations Board, 316 F.2d 389, 390-391 (D.C. Cir.
25 1963).)

26 As the Board said in Yakima Frozen Foods, 130

1 NLRB No. 128, 47 LRRM 1472, 1473-1474 (1961), affirmed
2 in Fruit and Vegetable Packers, supra,:

3 "The relevant rule of law,
4 as enunciated by the Supreme Court
5 in N.L.R.B. v. Truitt Manufacturing
6 Co., 351 U.S. 149, 38 LRRM 2042, is
7 as follows: where an employer claims
8 financial inability to pay a demanded
9 wage increase, his failure to furnish
10 on request substantiating financial
11 information may constitute a violation
12 of Section 8(a)(5) depending on the
13 facts of the particular case, the
14 ultimate inquiry being 'whether or
15 not under the circumstances of the
16 particular case, the statutory
17 obligation to bargain in good faith
18 has been met.' Under the Truitt
19 principle, the obligation to furnish
20 substantiating evidence does not
21 'automatically' follow a claim of
22 inability to pay, nor is the
23 employer obligated to substantiate
24 the claim; it is enough if the
25 employer in good faith attempts
26 to substantiate it.

1 Here, the "circumstances of the particular case"
2 are that the Company cooperated completely by supplying
3 the Union with a multitude of data on a multitude of
4 subjects and agreed to an unrestricted audit of its books
5 to substantiate its financial statements and its claim
6 of inability to pay; under prevailing authority, this
7 constitutes bargaining in good faith.

8 A refusal, such as here, to bare the books to
9 the union so that the union may pass upon the efficiency of
10 management or may pass upon whether there are any "dead-
11 heads" on the office payroll, is not a refusal to bargain;
12 "[t]o bargain collectively in compliance with the statute
13 does not mean that an employer must produce proof to
14 establish that he is right in his business decision as to
15 what he can, or cannot, afford to do. He is left free to
16 decide that himself. . . ." (National Labor Relations
17 Board v. Jacobs Manufacturing Co., 196 F.2d 680, 684
18 (2 Cir. 1952).)

19 The Board itself has held that the mere furnishing
20 of profit and loss statements, which is less than the
21 Company offered in the present case, is sufficient to meet
22 the requirements of good faith bargaining. (Albany
23 Garage, Inc., 126 NLRB No. 52, 45 LRRM 1329 (1960).
24 See also: Tennessee Chair Co., 126 NLRB No. 160, 45
25 LRRM 1472 (1960).)

26 The facts of the present case are entirely

1 different than those involved in this Court's recent
2 decision that failure to provide any substantiating data
3 is a refusal to bargain (National Labor Relations Board
4 v. Western Wirebound Box Co., 356 F.2d 88 (9 Cir. 1966),
5 because here, unlike in Western Wirebound, the Company
6 offered to permit an unrestricted audit of its books,
7 subject only to the requirement that the information be
8 treated confidentially. Where a company offers such
9 financial information, subject only to the requirement of
10 confidentiality, there is no refusal to bargain. (United
11 Fire Proof Warehouse Co. v. National Labor Relations Board,
12 356 F.2d 494, 499 (7 Cir. 1966).)

13 Finally, the full error of the Trial Examiner
14 and the Board in concluding that the Company refused to
15 bargain is emphasized by the acknowledged inability of
16 either to say precisely wherein the Company failed to
17 substantiate its claim of inability to pay; as the Trial
18 Examiner said (and as adopted by the Board) (TXD, p. 12,
19 lines 40-43):

20 "I cannot with preciseness
21 indicate here the scope that
22 the accountant's report should
23 take. Elaboration or explanation
24 of his conclusions should be
25 permitted; on the other hand
26 the report need not be an

1 efficiency survey and critique."

2 In other words, both the Trial Examiner and the
3 Board have concluded that the Company violated Section 8(a)
4 (5), but neither of them are able to say how far, in their
5 opinion, the Company has to go not to be in violation;
6 this not only underscores the departure of the Trial
7 Examiner and the Board from the principles established by
8 prevailing authority, but also is so vague as to raise
9 serious questions about the enforceability of the Board's
10 recommended order that the Company cease and desist from
11 "refusing, upon request, to substantiate its claim of
12 inability to pay any wage increase or other monetary
13 benefits." (TXD, p. 15, lines 34-39.)
14

15 V

16 THE STRIKE WAS AN ECONOMIC
17 STRIKE, AND WAS NOT CAUSED
18 BY ANY UNFAIR LABOR PRACTICE
19 BY THE COMPANY.

20 If a strike would have taken place even if a
21 company had not engaged in an unfair labor practice,
22 then the strike is not an unfair labor practice strike.
23 (NLRB v. Swinerton, 202 F.2d 511, 516 (9 Cir. 1953);
24 NLRB v. Barrett Co., 135 F.2d 959, 962 (7 Cir. 1943);
25 NLRB v. Stackpole Carbon Co., 105 F.2d 167, 176 (3 Cir.
26 1939), cert. den. 308 U.S. 605, 60 S.Ct. 142, 84 L.Ed. 506

1 (1939); NLRB v. Remington Rand, Inc., 94 F.2d 862, 872
2 (2 Cir. 1938), cert. den. 304 U.S. 576, 58 S.Ct. 1046,
3 82 L.Ed. 1540 (1938).)

4 Here, the only evidence that the strike was an
5 unfair labor practice strike was Mrs. Riley's testimony
6 that after the strike the union representatives explained
7 to the employees, ex post facto, that they had struck
8 because of the Company's "stalling tactics, refusal to
9 bargain, unfair labor practices and Mr. Shaw's complete
10 ignoring the union" (Tr. p. 167, lines 10-18); but a
11 mere assertion by a union that it is striking to protest
12 an unfair labor practice does not make the strike an
13 unfair labor practice strike, particularly where (as here)
14 such a finding is based upon the single statement of a
15 highly partisan witness long after the event. (NLRB v.
16 Scott & Scott, 245 F.2d 926, 929-930 (9 Cir. 1957). As
17 Judge Fee said of the situation in the Scott & Scott case,
18 the present case is one where the theory that "unfair
19 practices entered into the calling of the strike is
20 obviously an afterthought when other means had failed,"
21 and the "expression of the Trial Examiner [that the strike
22 was caused by an unfair labor practice] is inconclusive,
23 argumentative and inconsequential." (245 F.2d at 929-930.)

24 Mrs. Riley's testimony on cross-examination
25 shows that before the strike it was a good contract that
26 concerned the employees, not any refusal by the Company

1 to bare its books (see p. 9, line 11 - p. 10, line 15,
2 above). The situation here fits perfectly into the
3 following words from Winter Garden Citrus Food Coop. v.
4 National Labor Relations Board, 238 F.2d 128, 129 (5 Cir.
5 1956), relied upon by the Ninth Circuit in the Scott &
6 Scott case:

7 "It is apparent from . . . [Mrs. Riley's
8 testimony] . . . that the execution of
9 a contract between the employer and the
10 union with satisfactory wage provisions
11 was the central theme which occupied the
12 attention of all concerned. Practically
13 all of the efforts of the organizer were
14 directed towards bringing about a
15 satisfactory arrangement in that vital
16 field, and a number of bargaining sessions
17 were held in connection with it. The
18 labor practices above outlined had never
19 been considered by anyone as having such
20 an importance as possibly to occasion
21 a strike. There must be proof of causal
22 connection between the two to justify
23 the finding that the strike was bottomed
24 in part upon unfair labor practices
25 entitling striking employees to
26 reinstatement.

1 "A careful reading of the
2 evidence here fails to convince
3 us that the Board had before it
4 substantial evidence upon which
5 to base its finding of such a
6 causal connection."

7
8 VI

9 THE COMPANY DID NOT VIOLATE
10 THE OCTOBER 29, 1963
11 SETTLEMENT AGREEMENT.

12 The Trial Examiner says (TXD, p. 13, lines 40-43):

13 "By Respondent's conduct
14 described above in preceding
15 paragraphs, it has violated the
16 provisions of a settlement
17 agreement approved on October 29,
18 1963, providing that it would
19 bargain with the Union pursuant
20 to the provisions of the Act."

21 .

22 Inasmuch as the Company's "conduct described
23 above" was not a refusal to bargain, it could not in any
24 way be a violation of the settlement agreement.

25 / / /

26 / / /

VII

CONCLUSION

The Board has never ruled that an employer is under an obligation to "bare his books" to a union, or to any other employee representative and, on the contrary, the Board has rejected the principle "as inconsistent with the prevailing authority" and has specifically repudiated all "statements of principle and law with respect to an employer's obligation to substantiate a claim of inability to pay that are inconsistent with those set forth" in this brief. (Yakima Frozen Foods, 130 NLRB No. 128, 47 LRRM 1472, 1473-1474, footnotes 5 and 6 (1961).)

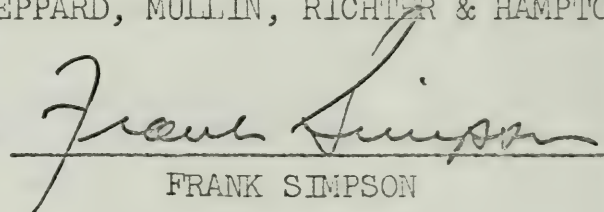
The Trial Examiner and the Board should be reversed, the Company's petition granted, and enforcement denied.

DATED: August 12, 1966.

Respectfully submitted,

SHEPPARD, MULLIN, RICHTER & HAMPTON

By


FRANK SIMPSON

Attorneys for Petitioner

CERTIFICATE OF SERVICE

I, the undersigned, say that I am and was at all times herein mentioned a citizen of the United States and a resident of the County of Los Angeles, State of California, over the age of 18 years and not a party to the within action; that my business address is 458 South Spring Street, Los Angeles, California 90013; that on 12 August 1966 I served PETITIONER'S OPENING BRIEF dated August 12, 1966, on the below-named counsel in said action, by depositing true copies thereof, enclosed in sealed envelopes with postage thereon fully prepaid, in a mail-box regularly maintained by the United States Government at 458 South Spring Street, Los Angeles, California, addressed as follows:

General Counsel, National Labor Relations Board,
21st Region, 849 South Broadway, Los Angeles,
California 90014
Attention: George A. Pappy, Esquire

Alfred M. Klein, Esquire, Messrs. Rose, Klein & Marias
315 West Ninth Street, Los Angeles, California 90015
(on behalf of International Brotherhood of Operative
Potters, AFL-CIO)

Plato E. Papps, Esquire
1300 Connecticut Avenue, Washington 6, D.C.
(on behalf of International Brotherhood of Operative
Potters, AFL-CIO)

/ / /

/ / /

/ / /

/ / /

1 and three copies of the above-named documents to:

2 Marcel Mallet-Prevost, Esquire
3 Assitant General Counsel
4 National Labor Relations Board
5 Washington, D.C. 20570

6 I declare under penalty of perjury that the
7 foregoing is true and correct.

8 Executed on 12 August 1966 at Los Angeles,
9 California.

10 

11

Eveline Yudico
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

No. 20299

In the United States Court of Appeals
for the Ninth Circuit

METLOX MANUFACTURING COMPANY, PETITIONER,

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

ON PETITION FOR REVIEW AND ON CROSS-PETITION FOR
ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR
RELATIONS BOARD.

BRIEF FOR THE NATIONAL LABOR RELATIONS
BOARD

FILED

SEP 23 1966

WM. B. LUCK, CLERK

ARNOLD ORDMAN,
General Counsel,

DOMINICK L. MANOLI,
Associate General Counsel,

MARCEL MALLET-PREVOST,
Assistant General Counsel,

ALLISON W. BROWN, JR.,
WARREN M. LADDON,
Attorneys,
National Labor Relations Board.

INDEX

	Page
Jurisdiction	1
Counterstatement of the Case	2
I. The Board's Findings of Facts.....	2
A. Background: the Union is certified; the Company refuses to bargain; then agrees to bargain in good faith in settlement of unfair labor practice charges	2
B. The Company claims inability to pay a wage increase and imposes conditions on a union audit of its books.....	3
C. The strike	10
II. The Board's Conclusions and Order.....	11
Argument	12
I. Substantial Evidence on the Record as a Whole Sup- ports the Board's Finding That the Company Vio- lated Section 8(a) (5) and (1) of the Act by Refusing the Union Access to Data Relevant to Substantiation of the Company's Claimed Inability to Grant a Wage Increase or Other Economic Benefits.....	12
II. Substantial Evidence on the Record as a Whole Sup- ports the Board's Finding That the Strike Which Began April 2, 1964, Was Caused by the Company's Unfair Labor Practices.....	21
Conclusion	24
Certificate	24
Appendix	25

AUTHORITIES CITED

Cases:

<i>Albany Garage Inc.</i> , 126 NLRB 417.....	20
<i>Curtiss-Wright Corp. v. N.L.R.B.</i> , 347 F. 2d 61 (C.A. 3) .	18, 19
<i>F.P.C. v. Hope Natural Gas Co.</i> , 320 U.S. 591.....	16
<i>Fruit & Vegetable Packers, Local 760 v. N.L.R.B.</i> , 316 F. 2d 389 (C.A. D.C.).....	13, 20
<i>General Drivers & Helpers Local 662 v. N.L.R.B.</i> , 302 F. 2d 908 (C.A. D.C.) cert. denied 371 U.S. 827.....	23

Cases—Continued

	Page
<i>Hollywood Brands v. N.L.R.B.</i> , 324 F. 2d 956 (C.A. 5) enf'g, 142 NLRB 304, 305 cert. denied 377 U.S. 923...	19
<i>Int'l Telephone & Telegraph Corp.</i> , 159 NLRB No. 145.	19
<i>N.L.R.B. v. Barrett Co.</i> , 135 F. 2d 959 (C.A. 7)	23
<i>N.L.R.B. v. Celotex Corp.</i> , 62 LRRM 2475 (C.A. 5)	12, 13
<i>N.L.R.B. v. Feed & Supply Center, Inc.</i> , 294 F. 2d 650 (C.A. 9)	12
<i>N.L.R.B. v. Fitzgerald Mills Corporation</i> , 313 F. 2d 260 (C.A. 2), cert. denied 375 U.S. 834	22
<i>N.L.R.B. v. Jacobs Mfg. Co.</i> , 196 F. 2d 680 (C.A. 2) ...	12, 17
<i>N.L.R.B. v. Stackpole Carbon Co.</i> , 105 F. 2d 167 (C.A. 3), cert. denied 308 U.S. 605	23
<i>N.L.R.B. v. Truitt Mfg. Co.</i> , 351 U.S. 149	12, 15
<i>N.L.R.B. v. West Coast Casket Co., Inc.</i> , 205 F. 2d 902 (C.A. 9)	22
<i>N.L.R.B. v. Western Wirebound Box Co.</i> , 356 F. 2d 88 (C.A. 9)	12
<i>N.L.R.B. v. Woolworth Co.</i> , 352 U.S. 938, rev'g 235 F. 2d 319 (C.A. 9)	13
<i>N.L.R.B. v. Wooster Div. of Borg-Warner Corp.</i> , 356 U.S. 342	15
<i>Northern Virginia Steel Corp. v. N.L.R.B.</i> , 300 F. 2d 168 (C.A. 4)	23
<i>Scott v. Scott</i> , 245 F. 2d 926 (C.A. 9)	23
<i>Sylvania Electric Products, Inc., v. N.L.R.B.</i> 358 F. 2d 591 (C.A. 1)	19
<i>Tennessee Chair Co.</i> , 126 NLRB 1357	21
<i>Yakima Frozen Foods</i> , 130 NLRB 1269	20
<i>Wallace Corp. v. N.L.R.B.</i> , 323 U.S. 248	11

Miscellaneous:

Barkin, <i>Financial Statements in Collective Bargaining</i> , 4 Labor Law Journal 753	16
Hills, <i>Law of Accounting I</i> , 54 Col. Law Rev. 1	16

**In the United States Court of Appeals
for the Ninth Circuit**

No. 20299

METLOX MANUFACTURING COMPANY, PETITIONER,

v.

NATIONAL LABOR RELATIONS BOARD, RESPONDENT

*ON PETITION FOR REVIEW AND ON CROSS-PETITION FOR
ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR
RELATIONS BOARD.*

**BRIEF FOR THE NATIONAL LABOR RELATIONS
BOARD**

JURISDICTION

This case is before the Court upon the petition of Metlox Manufacturing Company, for review of an order of the National Labor Relations Board, issued against it on July 12, 1965, following proceedings under Section 10 of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C. Sec. 151, *et seq.*). The relevant statutory provisions are reprinted *infra*, pp. 25-26. In its answer the Board requests enforcement of its order. The Board's decision and order (R. 36-52, 62-63)¹ are reported at 153 NLRB

¹ References to the formal documents reproduced as "Volume I, Pleadings," are designated "R." References to portions of the

No. 124. This Court has jurisdiction of the proceeding under Section 10(e) and (f) of the Act, the unfair labor practices having occurred in Manhattan Beach, California, where the Company, a California corporation, is engaged in the manufacture of ceramic dinnerware. No issue is presented as to the Board's jurisdiction.

COUNTERSTATEMENT OF THE CASE

I. The Board's Findings of Fact

The Board found that the Company failed to meet the bargaining requirements of Section 8(a)(5) of the Act, by first refusing to bargain with the certified representative of its employees, International Brotherhood of Operative Potters, AFL-CIO, hereafter called the Union, and then, following execution of a settlement agreement, by failing adequately to substantiate its claim of financial inability to grant a wage increase or other economic benefits as requested by the Union. The facts upon which the Board based its findings may be summarized as follows:

A. Background: the Union is certified; the Company refuses to bargain; then agrees to bargain in good faith in settlement of unfair labor practice charges.

Following a Board conducted election, the Union was certified on June 11, 1963, as exclusive collective bargaining representative of the Company's production and maintenance employees (R. 37). On June 13,

stenographic transcript reproduced pursuant to Court Rules 10 and 17, are designated "Tr." References to the General Counsel's Exhibits are designated "G.C. Ex."

1963, William Rail, vice president of the Union, wrote to company President E. K. Shaw requesting a bargaining meeting. This request was refused. On September 5, 1963, Alfred Klein, attorney for the Union, wrote to Peter Irwin, an attorney for the Company, again requesting that petitioner enter into contract negotiations. There was no response to this request, so on September 17, 1963, the Union filed an unfair labor practice charge with the Board (R. 3). The Company and Union settled that case by an agreement approved by the Board's Regional Director on October 29, 1963. The agreement provided that the Company would in the future bargain collectively with the Union in accordance with the requirements of the Act (R. 48).

B. The Company claims inability to pay a wage increase and imposes conditions on a union audit of its books.

On November 18, 1963, Mrs. Edwin Selvin, a labor relations consultant representing the Company, met with representatives of the Union for the first time. At this meeting, the Union submitted proposals which included a request for a wage increase of 35 cents an hour and "some additional cost items" such as an increase in the number of paid holidays (R. 38; G.C. Ex. 2(b), pp. 23-24). At the second meeting on November 29, Mrs. Selvin stated, "[W]e are going to have to reject not only the wage increase but all of the cost items" (R. 38-39; G. C. Ex. 2(b), p. 25). The Union asked Mrs. Selvin whether she was claiming inability to pay; she answered, "That is right, and I am willing to prove it" (G.C. Ex. 2(b), p. 86). "We can't come

here and lie to you . . . our books tell the story. The union doesn't know it; I don't know it, but our books know it . . .” (G.C. Ex. 2(b), p. 46). Going further, Mrs. Selvin explained to the members of the union bargaining committee, most of whom were rank-and-file employees of petitioner, “when I make a claim that we are unable to pay it, I have to be ready to prove it with facts and figures right off our books” (G.C. Ex. 2(b), p. 86).

At the next meeting, December 18, 1963, Union Representative Rail requested that the Company's books be “open to our auditor,” and this matter was discussed at some length (R. 39; G.C. Ex. 2(c), pp. 93-94, *et seq.*). At the next meeting on January 13, 1964, Mrs. Selvin submitted to the Union a copy of the Company's profit and loss “figures” for the calendar years 1961, 1962, and the first ten months of 1963 (R. 39; G.C. Ex. 4).² At this meeting, Mrs. Selvin, commenting on the Union's request that these reports be audited, said that the purpose of such an audit would be “to check that I have given you correct figures and it is limited to that.” (G.C. Ex. 2(d), p. 276). A further meeting of the parties was held the following day, January 14 (G.C. Ex. 2(e)).

On January 17, 1964, Alfred Klein, attorney for the Union, wrote to Mrs. Selvin as follows (R. 40; G.C. Ex. 3(a)):

In our opinion, and under the Board authorities, your summary of financial items is insufficient to enable the union to meet its obligation of bargain-

² The information supplied by the Company on this occasion is reproduced in the Trial Examiner's report (R. 39).

ing in good faith. Substantiating information and data of the general headings are hereby requested, and particularly of those figures set forth under the following main listings for the three years indicated:

- Net sales—less sales discounts
- Factory and Shipping Wages
- Other Salaries and Wages
- Materials, Supplies, Expenses
- Advertising and Commissions
- Financial Expenses, Interest, Factoring
- Depreciation

Request is, accordingly, made that an audit or a detailed accounting of these items be forthwith furnished and toward that end, the union is agreeable to designating a certified public accountant to obtain the same on your premises with direct instructions to keep the information confidential from third parties, competitors and the like.

In a reply letter of February 12, 1964, Mrs. Selvin set forth the conditions under which the Company would allow an inspection of its financial and related records, as follows (R. 40-41; G. C. Ex. 3(d)):

Let us get the matter of an audit of the Company's records defined:

As I understand it the Union was not satisfied with the information submitted in support of the Company's claim that its financial situation does not justify additional cost items at this time and demanded further proof of the matter. I have,

heretofor [sic], submitted profit and loss statements for three successive years. Also I submitted figures outlining cost of the Union's demands and showing conclusively that these demands could not possibly be met on the Company's present volume of business. I have made the following offer to prove our position:

1. The books and records may be examined in our office.

2. Such examination to be made by a Certified Public Accountant chosen by the Union and approved by the Company.

3. All costs of such examination to be borne by the Union.

4. Such accountant work directly with the Company's accountant who will make available to him the Company's records and give him necessary information pertinent to such records and allow him to examine them to the extent [the accountant chosen by the Union] deems necessary.

5. The accountant chosen by the Union to supply the Union only with the information as to whether or not the company's representations (already submitted to the Union) are true, and that the accountant be specifically instructed that the details of the Company's financial records are not to be disclosed to any third parties whatsoever, including the Union.

If we can agree to these conditions then we are ready to allow an approved accountant to proceed at once with the examination of our records.

In a letter dated February 14, 1964, Mr. Klein agreed to all Mrs. Selvin's conditions, save non-disclosure of details to the Union (R. 41; G. C. Ex. 3(e)). Mrs. Selvin answered by letter dated February 15, 1964, in which she asserted her belief that the Union intended to use information obtained from the Company's books in an effort to bargain about supervisory salaries. She restated the Company's position as follows (R. 42; G. C. Ex. 3(e)):

I have now offered *only proof* that the Profit and Loss Statement as I presented it, is a true and correct Profit and Loss Statement. Our books will reflect this. Your accountant will be free to determine the particulars which add up to the Profit and Loss figures which we give to the Union but we must insist that he do not divulge these particulars to the Union.

Mr. Klein for the Union answered by letter of February 19, 1964, in part as follows (R. 42-43; G. C. Ex. 3(g)):

I can certainly agree with you that the audit will only be used for that purpose and for none other. I fully agree with you that the union cannot negotiate as to the expenditures you have made nor the salaries you are paying supervisors and management employees. On the other hand, we believe it is within their prerogative to comment upon a relationship which salaries to unit workers should bear to salaries of white collar workers. Also, I believe they certainly can comment upon whether the failure to show a satisfactory operating state-

ment is due to a deliberate bleeding of the assets by officers and/or controlling stockholders. For example, if a corporation has a net income of \$100,000.00 and is paying a president a \$1,000,000.00 salary, I am positive the right of any person to argue that the corporation was being bled for that one salary is evident, even though that person cannot negotiate the president's salary.

I, therefore, agree with you that your company is not required to negotiate the remuneration of the executives and supervisors with the union, although to repeat, this information may well be necessary for the union to bargain in good faith even though it be kept strictly confidential. I further agree with you that no further use of such details can or should be made by the union.

Mrs. Selvin answered for the Company by letter of February 29, 1964, as follows (R. 43-44; G. C. Ex. 3(h)):

Replying to your letter of February 19 concerning the matter of a certified public accountant checking the figures of Metlox Manufacturing Co. which were submitted to Mr. Rail in the bargaining conference of January 13, 1964, and which have been the subject of considerable correspondence between us.

It is the Company's position (and on this position we will rest our case) that the Union is entitled *only to figures necessary to the bargaining*. We have taken the position that the Company is financially unable to grant the increases which the

Union demanded and we have offered proof of the figures we submitted, which included the Company's Profit and Loss Statements for the years 1961, 1962 and 1963 November 30 (which was the latest date available at the time of submission). We believe our obligation is covered by our offer to prove that our submission was true.

Our offer is set forth at length in our letter of February 12, 1964, and, since you claimed not to understand it completely, I clarified the matter in a further letter to you on February 15, 1964.

This offers the Union full opportunity to substantiate our claim. We stand on our right *not to have the details of the various classifications of expense, other than that pertaining to the factory and shipping employees*, made available to the Union for any purpose. It cannot possibly have any relativity to bargaining since the classifications which we will give your accountant an opportunity to check so that he is able to inform the Union whether our representations as to our financial position are true or false, are not negotiable matters, as you have yourself admitted in your letter of February 19.

Needless to say, we recognize that the Union is entitled to any specific information pertaining to the employees in the bargaining unit and to that extent we will give your certified public accountant permission to make such figures available to the Union which are applicable directly to the bargaining unit.

I have submitted the name of Steres, Alpert & Company, Certified Public Accountants, 6404 Wiltshire Boulevard, as having been designated by the Union to undertake this investigation. The Company has no objection to this firm of accountants representing the Union in this matter.

When and if we can come to an agreement as to the extent of the material to be made available to the Union by the accountant, we are ready to proceed and the investigation can commence at once. We will, of course, insist that our full understanding shall be set forth in writing.

C. *The strike*

During contract negotiations, the Union held periodic meetings to make progress reports to the employees (R. 48; Tr. 156-157, 169). The employees were told of the Company's claim of inability to meet any demands which would cost the Company more money, and that a request had been made to examine the Company's books (R. 48; Tr. 154-157). At a union meeting on February 20, 1964, Union Representative Rail told the employees "that he had requested that the Company's books be opened in order for us to determine whether we could receive a wage increase and he said he apparently was not making very much headway and if there was no decision reached on it he would be forced to file refusal-to-bargain charges" (R. 48; Tr. 160, 157-158). On March 4, Rail told the membership that the Company had supplied a profit and loss statement, but that it was "not enough material for us to use" (R. 48; Tr. 162-163, 160). The members were

informed that an unfair labor practice charge had been filed with the Board. The possibility of a strike was also discussed (R. 48; Tr. 161). At the next meeting on March 11, a strike vote was taken and 72 employees favored a strike, while 8 were opposed (R. 48; Tr. 163). However, no strike date was fixed. On April 1, Rail reported to the membership that no progress was being made in negotiations and stated his view that apparently the only alternative was to strike (R. 48; Tr. 166). By unanimous vote, the employees voted to strike (*ibid.*). The following morning, April 2, another meeting was held. Since attendance at this meeting was larger than the day before, Rail explained again why he thought it was necessary to strike (R. 48; Tr. 166-167). The strike commenced that day and was still in progress at the time of the hearing in this case on November 18 and 19, 1964 (R. 48; Tr. 168).

II. The Board's Conclusions and Order

The Board concluded that the Company refused to bargain in good faith with the Union, thereby violating Section 8(a)(5) and (1) of the Act, by unduly restricting the Union's examination of its financial and other records in an effort to inquire into, and substantiate the Company's claimed inability to pay a wage increase or grant other economic benefits to its employees.³ The

³ Since the Board's finding is that the Company's conduct following execution of the settlement agreement and its approval by the Regional Director on October 29, 1963, amounted to a refusal to bargain, the Board went behind the settlement agreement and considered the Company's conduct prior thereto. The Board thus found that the Company also unlawfully refused to bargain with the Union from June 13, 1963 to October 29, 1963 (R. 48). See *Wallace Corporation v. N.L.R.B.*, 323 U.S. 248, 253-254. The Company does not contest this latter finding (Co. br., p. 2).

Board further found that the strike commencing April 2, 1963, was caused by the Company's refusal to bargain in good faith with the Union.

The Board ordered the Company to cease and desist from refusing to bargain in good faith with the Union, and from interfering in any manner with the efforts of the Union to bargain collectively for all employees in the appropriate unit. Affirmatively, the Company was ordered to bargain collectively with the Union upon request; upon application to reinstate the striking employees to their former or substantially equivalent positions; to make them whole for any loss of earnings resulting from a failure to reinstate; and to post appropriate notices.

ARGUMENT

I. Substantial Evidence on the Record as a Whole Supports the Board's Finding That the Company Violated Section 8(a)(5) and (1) of the Act by Refusing the Union Access to Data Relevant to Substantiation of the Company's Claimed Inability to Grant a Wage Increase or Other Economic Benefits.

It is well settled that when an employer claims financial inability to grant a demanded wage increase or other economic benefits, he must attempt in good faith to substantiate that claim when he is requested by his employees' bargaining representative. *N.L.R.B. v. Truitt Manufacturing Co.*, 351 U.S. 149; *N.L.R.B. v. Western Wirebound Box Company*, 356 F. 2d 88 (C.A. 9); *N.L.R.B. v. Feed and Supply Center*, 294 F. 2d 650 (C.A. 9); *N.L.R.B. v. Jacobs Manufacturing Co.*, 196 F. 2d 680, 682-684 (C.A. 2); *N.L.R.B. v. Celotex Corp.*, No. 21994, decided June 28, 1966, 62 LRRM 2475 (C.A. 5). The ultimate inquiry is simply whether, on the

facts of the particular case, the employer has met his statutory duty to bargain in good faith. "What degree of cooperation is to be required, under any particular set of circumstances, from the parties at the bargaining table, is largely a matter for the Board's expertise." *Fruit & Vegetable Packers and Warehousemen, Local 760 v. N.L.R.B.*, 316 F. 2d 389, 390-391 (C.A. D.C.); see also *N.L.R.B. v. Celotex Corp.*, *supra* 62 LRRM at 2477. Here the Board in affirming the carefully reasoned decision of the Trial Examiner, "acted within its allowable discretion in finding that under the circumstances of this case" the Company's refusal to provide the information sought by the Union constituted an unfair labor practice. *N.L.R.B. v. Woolworth Co.*, 352 U.S. 938, reversing, 235 F. 2d 319 (C.A. 9).

In its brief to the Court, the Company succinctly summarizes the conditions under which it was willing to let the Union examine its books (Co., br., p. 8) :

- (1) The examination to be in the Company's office;
- (2) by a Certified Public Accountant chosen by the Union and approved by the Company;
- (3) with the cost borne by the Union; and
- (4) with the details of the Company's financial records not to be disclosed to any third parties, including the Union, except to advise the Union whether the Company's profit and loss statements were true.

The principal issue before the Court is whether the Board was reasonable in finding, as it did, that the fourth condition imposed by the Company was unduly restrictive and inconsistent with the Company's obli-

gation to deal on open and frank terms with the Union. In short, the inquiry is whether the Company, by imposing the fourth condition, failed to comply with the standard of good faith required by the Act.

The Company's fourth condition had a two-fold effect: first, it blocked free communication between the Union and any certified public accountant it employed, thereby interfering with the agency relationship; and second, it prevented the Union from obtaining the information it felt it needed to evaluate the Company's claimed inability to pay, namely, whether the profit and loss statements gave a true picture of the Company's financial condition. Even if, after examining the Company's financial records, the accountant had concluded that the Company's inability-to-pay plea was not justified because the profit and loss statements did not accurately reflect the Company's financial condition, under the Company's restriction he would have been prevented from informing the Union of this fact, since he was limited to informing the Union whether the profit and loss statements were true.

The Trial Examiner, in his decision, as affirmed by the Board, took pains to point out that the result reached here was not intended to sanction a union "fishing expedition in a search for items on which to make efficiency recommendations or for flaws in managerial judgment" (R. 45). Obviously, the Company does not have to negotiate or conduct discussions with the Union about matters which are outside the scope of mandatory bargaining as defined in the Act.⁴ How-

⁴ Section 8(d) of the Act defines the bargaining obligation as that of meeting at reasonable times and conferring in good faith "with

ever, as we have seen, here the Company, when it claimed inability to pay increased wages, made this issue "highly relevant" to the negotiations. *N.L.R.B. v. Truitt Mfg. Co.*, *supra*, 351 U.S. at 152. As the Supreme Court pointed out in the *Truitt* case (*id.* at 152-153):

The ability of an employer to increase wages without injury to his business is a commonly considered factor in wage negotiations. Claims for increased wages have sometimes been abandoned because of an employer's unsatisfactory business condition; employees have even voted to accept wage decreases because of such conditions.

Good faith bargaining necessarily requires that claims made by either bargainer should be honest claims. This is true about an asserted inability to pay an increase in wages. If such an argument is important enough to present in the give and take of bargaining, it is important enough to require some sort of proof of its accuracy. [Citations and footnotes omitted.]

Proof of the accuracy of the Company's claim of inability to pay a wage increase, as the Board found here, was not provided by the profit and loss statements which the Company furnished. The Board's conclusion in this regard was fortified in part by the testimony of Certified Public Accountant Leon C. Steres, whom the Board deemed qualified as an expert witness

respect to wages, hours and other terms and conditions of employment." See *N.L.R.B. v. Wooster Div. of Borg-Warner Corp.*, 356 U.S. 342, 348-350, where the Supreme Court delineated the scope of mandatory bargaining.

in the field of accounting and auditing (R. 45). Mr. Steres, in addition to an impressive career as a public accountant, has taught various accounting courses over a period of many years at the University of California in Los Angeles (Tr. 43-45). As Mr. Steres indicated, a profit and loss statement is only one factor to consider in arriving at a judgment or opinion as to the financial soundness of a company (R. 45; Tr. 67-69).⁵ In order to analyze such a statement, or to ascertain the financial condition of a company, more information may well be required, such as knowledge about the accounting method used and whether there has been any recent change in method; whether the company has experienced unusual or non-recurring expenses; the manner in which depreciation is handled by the company; the way in which non-operational items are treated for accounting purposes; how inventories are evaluated; how maintenance expenses are accounted for, either on a current basis or capitalized and spread over their useful life. The same question can be asked with respect to expenses for purchases of materials and research and development costs, that is, whether

⁵ "An accounting statement . . . in the absence of evidence tending to prove that it correctly reflects the effect of reported transactions . . . is merely a piece of paper." Hills, *Law of Accounting I*, 54 Col L. Rev. 1; see also opinion of Justice Jackson, *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 643, n. 40, "As a representation of the condition and trend of a business, [accounting] uses symbols of certainty to express values that actually are in constant flux . . . If one cannot rely on accountancy accurately to disclose past or current conditions of business, the fallacy of using it as a sole guide to future price policy ought to be apparent." And see Barkin, *Financial Statements in Collective Bargaining*, 4 Labor Law Journal 753.

they are treated as current expenses or on a capitalized basis (R. 46; Tr. 67-69, 71, 77, 79-80, 83-84, 86-92, 98, 103-105, 115-116). The answers to these various questions, as the Board pointed out in its decision, would not entitle the Union in this case to bargain about questions which are matters of management and direction of the Company, but would only supply it with substantiation that the figures of profit and loss supplied by the Company, in addition to being accurate, constitute fair representations of the Company's financial condition (R. 46-47).

There is no dispute here as to the correctness of the Company's contention that the Union is not entitled to use information obtained from the Company's financial records for the purpose of bargaining about the "efficiency of management" or whether there are any "deadheads" on the office payroll (Co. br., pp. 12, 14). Union Attorney Klein, in his letter to the Company dated February 19, 1964, conceded that "the union cannot negotiate as to the expenditures you have made nor the salaries you are paying supervisors and management employees" (G.C. Ex. 3(g)). The Company also properly quotes language from the opinion in *N.L.R.B. v. Jacobs Mfg. Co.*, 196 F. 2d 680, 684, (C.A. 2), standing for the same proposition. Indeed, as we pointed out *supra*, a union has no right to demand negotiations on any subject outside the scope of mandatory bargaining as prescribed by the Act. But to say that the duty to bargain does not extend to matters of business decision or managerial prerogative is not to say that the Union may be denied access to informa-

tion concerning such matters if the information is requested and is *relevant* to the collective bargaining relationship.

An argument similar to that made by the Company here was made by the employer in *Curtiss-Wright Corp. v. N.L.R.B.*, 347 F. 2d 61 (C.A. 3). There the Union, for purposes of bargaining and processing grievances for employees within a bargaining unit of salaried office, clerical and engineering employees asked for detailed information, including *inter alia*, job evaluation factors and wage rates for a large class of administrative employees outside the bargaining unit. The Union's particular concern was with the fact that the bargaining unit was being gradually reduced in size, while the administrative group was growing. The Union believed that employees classified as administrative were doing work which actually should have been allocated to those in the bargaining unit. The Court affirmed the Board's finding that the employer's refusal to furnish the requested information was in violation of Section 8(a)(5), noting that the information was relevant because it would assist the Union in determining the best contract provisions to request at the bargaining table and what relief it could seek through the prosecution of grievances, 347 F. 2d at 69-70. In answering the employer's contention that it was not required to furnish information about the employees outside the bargaining unit *because bargaining as to them was not mandatory*, the Court stated (347 F. 2d at 70):

It is well within the responsibility of the Union in the instant case in executing its duty to protect the

interests of the employees in the bargaining unit it represents to closely scrutinize all facets relating to any encroachment upon the rights of those unit employees to the end that a stable employment structure for the members of the bargaining unit may be maintained.

The key question in deciding cases of this type, therefore, as the Third Circuit recognized in the *Curtiss-Wright* case is not whether the requested information relates to matters that are within the ambit of managerial decision, but whether "the requested data is relevant and, therefore reasonably necessary, to a union's role as bargaining agent" 347 F. 2d at 68. Accord: *Sylvania Electric Products, Inc. v. N.L.R.B.*, 358 F. 2d 591, 592-593 (C.A. 1), petition for certiorari pending; *Hollywood Brands v. N.L.R.B.*, 324 F. 2d 956 (C.A. 5), enforcing 142 NLRB 304, 305, cert. denied, 377 U.S. 923; *International Telephone and Telegraph Corp.*, decided June 29, 1966, 159 NLRB No. 145, 62 LRRM 1339, 1342. As we have seen, the information requested by the Union in the instant case, and which the Company refused to provide, fully satisfied the criterion of relevancy. The profit and loss statements furnished by the Company did not disclose sufficient information from which a fair judgment could be made as to the validity of the Company's claim of inability to pay a wage increase. C.P.A. Steres, a recognized expert in accounting matters, confirmed this view. Accordingly, the additional information sought by the Union was manifestly relevant to the negotiations.

Respondent has mistakenly cited as justification for its position in this proceeding the Board's decision in *Yakima Frozen Foods*, 130 NLRB 1269, remanded on other grounds *sub nom*, *Fruit and Vegetable Packers and Warehousemen Local 760 v. N.L.R.B.*, 316 F. 2d 389 (C. A. D.C.). That case is fully distinguishable from the one at bar, because there, unlike the instant situation, the employer did not impose a barrier to communication between the C.P.A. auditor and the Union. The employer there was willing to submit his books and records to an audit in substantiation of the balance sheet which he had offered to the Union, and although he refused to permit union agents, as such, to be present during the audit, the C.P.A. was not limited as to what he could tell the union concerning the results of his audit.⁶ That case stands in marked contrast to the instant one, since here the Company would not permit the Union access to any of the information to which it was entitled by way of substantiating the profit and loss statements which had been submitted. *Albany Garage, Inc.*, 126 NLRB 417, also relied on by the Company (br., p. 14), is likewise distinguishable on its facts from the case at bar. There the Union had not objected in previous years to financial data of the type furnished by the employer; the employer's claim of inability to grant a wage increase was based in part on a prediction of business conditions in the industry; and the employer offered to include a six-

⁶ The only item of information which the employer in *Yakima Frozen Foods* regarded as confidential and which he restricted the auditor from transmitting to the Union concerned his sources of supply and the consignees of his products; he was concerned about the possibility of secondary boycotts. 130 NLRB 1271, n. 2.

month wage reopener in a new contract in order to permit an early review of wages and to determine if conditions at that time justified an increase. 126 NLRB at 418. In the light of all the circumstances presented in that case the Board merely held that the employer had fulfilled its obligation to bargain in good faith. The Board, in the exercise of its statutory authority, has concluded to the contrary here.⁷

II. Substantial Evidence on the Record as a Whole Supports the Board's Finding That the Strike Which Began April 2, 1964, Was Caused by the Company's Unfair Labor Practices.

As shown in the Counterstatement, the Union was certified on June 11, 1963, but petitioner refused to bargain until after unfair labor practice charges had been filed with the Board. The basis of the settlement reached on October 29, 1963, was petitioner's agreement to bargain in good faith in the future. It was against this background that Union Representative Rail reported at a union meeting on February 20, 1964, that if the Company continued in its refusal to substantiate its claimed inability to pay a wage increase, additional unfair labor practice charges would be filed. On March 4, Rail told the membership that in his opinion the profit and loss statement submitted by the Company was not enough information and therefore he had filed a refusal-to-bargain charge. On April 1, Rail reported no further progress and advised that a

⁷ *Tennessee Chair Company*, 126 NLRB 1357, cited by the Company (br., p. 14) does not support its position at all. The Board there found that the employer violated Section 8(a)(5) by refusing to furnish financial data to substantiate a claimed inability to pay a wage increase.

strike appeared to be the Union's only alternative. The members voted unanimously to strike. The morning of April 2, at another meeting, Rail listed again for the members the reasons that he felt necessitated the strike—stalling tactics, refusal to bargain, unfair labor practices and the Company's "complete ignoring the Union" (Tr. 167). The strike commenced that day, and was still in progress seven months later when the hearing was held in this case.

On the basis of the evidence, there can be no question but that the strike was the result of the Company's breach of the settlement agreement and its continuing refusal to bargain in good faith. The Company's unwillingness to supply the financial information sought by the Union was discussed many times by the employees prior to the strike, and the Company ignores the record completely when it suggests in its brief (pp. 9-10, 17-18) that the Company's refusal to furnish the data and the lack of good faith which the Company's attitude demonstrated did not motivate the strike action. That the employees' basic objective throughout this period was to obtain improved economic benefits from the Company does not detract from the validity of the Board's conclusion that the work stoppage was an unfair labor practice strike. Even though "other reasons were also present," it is enough to show that it was an unfair labor practice strike if "one of the reasons for it was to protest an unfair labor practice." *N.L.R.B. v. West Coast Casket Co.*, 205 F.2d 902, 907 (C.A. 9), and cases cited; see also *N.L.R.B. v. Fitzgerald Mills Corp.*, 313 F.2d 260, 269 (C.A. 2), cert. denied 375 U.S. 834; *General Drivers and Helpers*

Union, Local 662 v. N.L.R.B., 302 F. 2d 908, 911 (C.A. D.C.), cert. denied, 371 U.S. 827; *Northern Virginia Steel Corp. v. N.L.R.B.*, 300 F. 2d 168, 174-175 (C.A. 4).

The Company attempts to argue that the strike would have occurred even if it had not been for its unfair labor practices (Co. br., pp. 16-17). This argument is without merit, however, and completely without support in the record. As the cases cited by the Company (br., p. 16) indicate, the burden rests on the employer making such an argument "to show that the strike would have taken place even if he had not refused to bargain." *N.L.R.B. v. Barrett Co.*, 135 F. 2d 959, 962 (C.A. 7). This the Company "has not done and this we believe it cannot do." *N.L.R.B. v. Stackpole Carbon Co.*, 105 F. 2d 167, 176 (C.A. 3), cert. denied 308 U.S. 605. Equally misplaced is the Company's reliance on *Scott v. Scott*, 245 F. 2d 926 (C.A. 9). That case merely holds that in order to be characterized as an unfair labor practice strike, substantial evidence must show a causal connection between any unfair labor practice and the subsequent strike. We have shown *supra* that substantial evidence fully supports the Board's finding that the strike in the instant case was caused by the Company's failure to bargain in good faith.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for review should be denied and the Board's order should be enforced in full.

ARNOLD ORDMAN,

General Counsel,

DOMINICK L. MANOLI,

Associate General Counsel,

MARCEL MALLET-PREVOST,

Assistant General Counsel,

ALLISON W. BROWN, JR.,

WARREN M. LADDON,

Attorneys,

National Labor Relations Board.

September 1966.

CERTIFICATE

The undersigned certifies that he has examined the provisions of rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST,

Assistant General Counsel,

National Labor Relations Board.

APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any and all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8 (a) (3).

UNFAIR LABOR PRACTICES

Sec. 8 (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * * *

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9 (a).

* * * * *

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good

faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession:

*

*

*

*

*

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

METLOX MANUFACTURING COMPANY,

Petitioner,

v.

NATIONAL LABOR RELATIONS BOARD,

RESPONDENT.

No. 20,299

On Petition to Set Aside Decision and
Order of the National Labor Relations Board

PETITIONER'S REPLY BRIEF

FILED

OCT 11 1966

WM. B. LUCK, CLERK

SHEPPARD, MULLIN, RICHTER & HAMPTON

458 SOUTH SPRING STREET
LOS ANGELES, CALIFORNIA 90013

TOPICAL INDEX

Page

I

Although the Board, in its brief, correctly states the basic law and the basic inquiry governing this case, it incorrectly applies that law to the inquiry ----- 1

A. As the Board says, the law governing this case is simply stated: When an employer claims financial inability to grant economic benefits, he must stand ready to attempt in good faith to substantiate that claim ----- 1

B. As the Board says, the question in this case is simply stated: Was the "Fourth Condition" imposed by the company a lack of good faith bargaining? ----- 2

C. The Board, despite its correct statement of the law and of the inquiry in this case, has fallen into error in its application of the law to the inquiry -- 2

II

The company offered to permit actual substantiation of its inability to pay increased economic benefits, and it is irrelevant that the details of the company's financial records were not to be disclosed to the union ----- 4

A. The company offered to permit actual substantiation of its claim of inability to pay increased economic benefits ----- 5

B. In view of the carte blanche given by the company to the C.P.A. chosen by the union, it is irrelevant that the C.P.A. was not to disclose to the union the details of the company's financial records ----- 6

III

Conclusion ----- 13

1 TABLE OF AUTHORITIES CITED

2 <u>Cases</u>	<u>Page</u>
3 Fruit & Vegetable Packers v. NLRB, 316 F. 2d	
4 389 (D.C. Cir. 1963) -----	4, 12
5 NLRB v. Jacobs Mfg. Co., 196 F. 2d	
6 680 (2 Cir. 1952) -----	9
7 NLRB v. Truitt Manufacturing Co.,	
8 351 U.S. 149 (1956) -----	4
9 Yakima Frozen Foods, 130 NLRB No. 128,	
10 47 LRRM 1472 (1961) -----	4

1 IN THE UNITED STATES COURT OF APPEALS
2 FOR THE NINTH CIRCUIT

3 METLOX MANUFACTURING COMPANY,)

4 Petitioner,)

5 v.)

No. 20,299

6 NATIONAL LABOR RELATIONS BOARD,)

7 Respondent.)

8
9 On Petition to Set Aside Decision and
10 Order of the National Labor Relations Board

11 PETITIONER'S REPLY BRIEF
12

13 I

14 ALTHOUGH THE BOARD, IN ITS BRIEF, CORRECTLY STATES
15 THE BASIC LAW AND THE BASIC INQUIRY GOVERNING
16 THIS CASE, IT INCORRECTLY APPLIES THAT
17 LAW TO THE INQUIRY.

18 A. As The Board Says, The Law Governing This Case is Simply
19 Stated: When An Employer Claims Financial Inability To
20 Grant Economic Benefits, He Must Stand Ready To Attempt
21 In Good Faith To Substantiate That Claim.

22 At page 12 of its brief, the Board states:

23 "It is well settled that when an employer
24 claims financial inability to grant a demanded
25 wage increase or other economic benefits, he
26 must attempt in good faith to substantiate

1 that claim when he is requested by his employees'
2 bargaining representative. [Citations.] The
3 ultimate inquiry is simply whether, on the facts
4 of the particular case, the employer has met
5 his statutory duty to bargain in good faith."

6 This is an accurate statement of the law in this case.

7 B. As The Board Says, The Question In This Case Is Simply
8 Stated: Was The "Fourth Condition" Imposed By The
9 Company A Lack of Good Faith Bargaining?

10 At page 14 of its brief, the Board states:

11 "In short, the inquiry is whether the Company,
12 by imposing the fourth condition¹, failed to
13 comply with the standards of good faith
14 required by the Act."

15 This is an accurate statement of the inquiry in this
16 case. (See also, Company's Br., p. 10; TXD, p. 9, lines
17 30-34.)

18 C. The Board, Despite Its Correct Statement Of The Law And
19 Of The Inquiry In This Case, Has Fallen Into Error In
20 Its Application Of The Law To The Inquiry.

21

22
23 ¹ The "fourth condition" (actually item 5 in the
24 Company's letter of February 12, 1964) was merely that the
25 C.P.A. who was to have audited the Company's books could not
26 disclose the details of the Company's financial records to
any third parties, including the Union, except to advise the
Union whether the Company's prior representations to the
Union were true. (TXD, p. 6, lines 12-19; p. 9, lines 30-34.)

1 Despite the Board's correct statements in its brief (1)
2 that good faith bargaining merely requires than an employer
3 attempt to substantiate a claim of inability to pay and (2)
4 that the inquiry here is whether the Company met that re-
5 quirement, the entire thrust of the Board's argument here
6 goes far beyond what the Board says the law is and contends
7 that the Company, although attempting to substantiate its
8 claim, did not permit actual substantiation and thus refused
9 to bargain in good faith. This contention is erroneous for
10 three reasons:

11 1. It is clear that the Board, in this case, has de-
12 parted from established law and has held the Company guilty
13 on the theory that the Company did not permit actual substan-
14 tiation, as distinguished from the Company's making a good
15 faith attempt at substantiation. According to the Trial
16 Examiner, as adopted by the Board, (TXD, p. 12, lines 37-40):

17 "I find that Respondent in limiting the
18 accountant to a 'yes or no' report is not
19 substantiating or permitting substantiation
20 of its inability-to-pay plea, and by this
21 conduct it has not bargained in good faith."

22 2. Not only is this "finding" by the Board in error
23 because it erroneously assumes that actual substantiation is
24 required, but it is error for the Board to characterize it
25 as a "finding"; it is a matter of law, not of fact, whether
26 an employer violates the Act by not permitting the Union to

1 make a general inspection of its books and records. (Yakima
2 Frozen Foods, 130 NLRB No. 128, 47 LRRM 1472, 1473 (1961)
3 affirmed, 316 F. 2d 389 (D.C. Cir. 1963).)

4 As conceded by the Board at page 12 of its brief, the
5 relevant rule of law does not require actual substantiation,
6 but merely a good faith attempt at substantiation. The
7 relevant rule of law, under the Truitt (351 U.S. 149)
8 principle, is that the obligation to furnish substantiating
9 evidence does not "automatically" follow a claim of inability
10 to pay, nor is the employer obligated to substantiate the
11 claim; it is enough if the employer in good faith attempts to
12 substantiate it. (Yakima Frozen Foods, supra, 47 LRRM at
13 pp. 1473-1474.)²

14 3. In any event, regardless of the relevant rule of
15 law, the Company here offered to permit actual substantiation
16 of its inability to pay, and any "finding" or "conclusion" by
17 the Board to the contrary is unsupported by, and is contrary
18 to, the evidence, as shown below.

19 II

20 THE COMPANY OFFERED TO PERMIT ACTUAL SUBSTANTIATION
21 OF ITS INABILITY TO PAY INCREASED ECONOMIC
22 BENEFITS, AND IT IS IRRELEVANT THAT THE DETAILS
23 OF THE COMPANY'S FINANCIAL RECORDS WERE
24 NOT TO BE DISCLOSED TO THE UNION.

25 ² In footnote 6 in the Yakima Frozen Foods case
26 (47 LRRM at p. 1474), the Board specifically repudiated all
statements of principle and law to the contrary.

1 A. The Company Offered To Permit Actual Substantiation Of
2 Its Claim Of Inability To Pay Increased Economic Benefits.

3 In the exchange of correspondence between the Company
4 and the Union, the Union questioned the extent to which the
5 C.P.A. could examine the Company's books. (G.C. 3(e).)
6 Mrs. Selvin (the Company's negotiator) replied by letter
7 that the C.P.A. had carte blanche (G.C. 3(f)):

8 "You have misconstrued my meaning in this
9 case and upon reading it again, I suspect that
10 I may not have made it quite clear. My intention
11 was that your accountant may examine the
12 records, working with our accountant, and
13 your accountant will be allowed to examine
14 the records to the extent he deems necessary
15 to establish the proof of our representations
16 of financial position. I did not intend to
17 limit him to an examination which our accoun-
18 tant believed was necessary." (Emphasis in
19 original letter.)

20 Although the Trial Examiner, as adopted by the Board,
21 quoted a lengthy portion of this letter from Mrs. Selvin in
22 his Decision (TXD, p. 6, line 39 - p. 7, line 45), for some
23 unexplained reason he failed to quote or refer to the crucial
24 portion just quoted hereinabove. This is a critical omission
25 by the Trial Examiner and the Board.

26 Mr. Steres, the C.P.A. chosen by the Union and

1 accepted by the Company to audit the Company's books, was
2 called as an expert witness by the Board. (Board's Br.,
3 pp. 15-16; TXD, p. 10, lines 42-44.) He testified at great
4 length (Tr. pp. 44-138) as to the scope of the examination
5 he deemed necessary, and pursuant to the Company's offer, he
6 had complete carte blanche to investigate everything encom-
7 passed within his testimony. The exhaustive extent of the
8 examination which he would have performed (and to which the
9 Company agreed) is summarized in the Appendix hereto, and
10 not only shows that by agreeing thereto the Company offered
11 to permit actual substantiation of its financial position,
12 but also brings into crystal-clear focus the crucial failure
13 of the Trial Examiner and Board to quote or to refer to that
14 portion of Mrs. Selvin's letter giving the C.P.A. carte
15 blanche "to establish the proof of our representations of
16 financial position."

17 B. In View Of The Carte Blanche Given By The Company To The
18 C.P.A. Chosen By The Union, It Is Irrelevant That The
19 C.P.A. Was Not To Disclose To The Union The Details Of
20 The Company's Financial Records.

21 At pages 17-19 of its brief, the Board argues that
22 the Company's so-called "fourth condition" would have deprived
23 the Union of information "relevant" to the collective bar-
24 gaining. However, this is not so for a variety of reasons:

25 1. The Board in its brief is as vague as the Trial
26 Examiner was in his Decision (and as the Board was in adopting

1 the Trial Examiner's Decision) in pointing out just what
2 information it claims is "relevant" and why it claims it is
3 "relevant". In his Decision, adopted by the Board, the Trial
4 Examiner was unable to say exactly what details of the
5 Company's financial records he thought should be divulged to
6 the Union (TXD, p. 12, lines 40-43):

7 "I cannot with preciseness indicate here the
8 scope that the accountant's report should take.
9 Elaboration or explanation of his conclusions
10 should be permitted; on the other hand, the
11 report need not be an efficiency survey and
12 critique."

13 It its brief, the Board is just as vague. True, the
14 Board says (Board's Br., p. 19) that "As we have seen, the
15 information requested by the Union in the instant case, and
16 which the Company refused to supply, fully satisfied the
17 criterion of relevancy. . . . Accordingly, the additional
18 information sought by the Union was manifestly relevant to
19 the negotiations." However, this assertion by the Board is
20 vague, in that nowhere does the Board spell out what "infor-
21 mation" it has reference to.

22 Initially, the Union requested "substantiating infor-
23 mation and data of the general headings [of the profit and
24 loss statements]" (G.C. 3(a)), later the Union requested
25 "an audit, detailed accounting of the items therein set forth
26 [i.e., in the profit and loss statements] and substantiating

1 information and data" and "a full audit of all the company's
2 financial books and records pertaining to its claimed
3 financial condition" (G.C. 3(e)), and finally the Union
4 requested "the various breakdowns" (G.C. 3(g)).

5 If the Board is now contending that the Union should
6 be given all the information it requested, this, of course,
7 means all the information encompassed by Mr. Steres' testi-
8 mony (see Appendix) and this present contention by the Board
9 in its brief therefor goes far beyond the above quoted
10 contention by the Board in its decision.

11 On the other hand, if the Board in its brief does not
12 intend to go beyond the Board in its decision, then it is
13 uncertain what specific "information" the Board now considers
14 "relevant" to negotiations, and this not only is not spelled
15 out in the Board's brief, but is expressly held to be uncer-
16 tain in the Board's decision.

17 Finally, the only "relevancy" which the Board claims
18 for this unspecified "information" is that, supposedly, it
19 would supply the Union "with substantiation that the figures
20 of profit and loss supplied by the Company, in addition to
21 being accurate, constitute fair representations of the
22 Company's financial condition." (Board's Br., p. 17; see
23 also, Board's Br., p. 19.) However, as shown above, this
24 substantiation would have been supplied in every way by the
25 carte blanche audit by Mr. Steres, and in no way depended
26 upon additional disclosure of the Company's financial records

1 to the Union. Such disclosure, therefore, is irrelevant to
2 the only reason given by the Board in support of its conten-
3 tion of relevancy, and the Board not only does not contend
4 that the information is relevant for any other purpose, but
5 concedes that it is specifically irrelevant insofar as being
6 negotiable is concerned. (Board's Br., pp. 14, 17-18.)³

7 2. The only relevant question was whether the Company,
8 in good faith, had reached its decision that it could not
9 afford to meet the Union's demand and, in good faith, had
10 placed this claim on the bargaining table; it was totally
11 irrelevant whether the Company was right or wrong in its
12 business decision as to what it could, or could not, afford
13 to do. (NLRB v. Jacobs Mfg. Co., 196 F. 2d 680, 684 (2 Cir.
14 1952).)

15 Since the Company already had given its profit and
16 loss statements for 1961, 1962 and 1963 to the Union (TXD,
17 p. 4, lines 15-65) (and the Company offered, but the Union
18 refused, profit and loss statements for the past 10 years
19 (G.C. 2(c), p. 114, lines 1-5; p. 117, line 20 - p. 119,
20 line 5)), the only remaining relevant question was whether
21

22 ³ It should be kept in mind that, although the
23 Company refused generally to permit Mr. Steres to disclose
24 the details of the Company's financial records to the Union,
25 the Company specifically agreed that he could disclose "any
26 specific information pertaining to the employees in the bar-
gaining unit and to that extent we will give your certified
public accountant permission to make such figures available
to the Union which are applicable directly to the bargaining
unit." (TXD, p. 9, lines 11-15; G.C. 3(h).)

1 the P&L's were fair presentations of the Company's financial
2 condition.

3 Mr. Steres, the Certified Public Accountant chosen by
4 the Union and given carte blanche by the Company to perform
5 the audit and also the C.P.A. relied upon by the Board as its
6 expert witness, testified that, following his completion of
7 the exhaustive audit as agreed to by the Company (and as
8 summarized in the Appendix hereto), he would have been able
9 to have told the Union that the Company's profit and loss
10 statements were fair presentations and fairly presented the
11 results of operations, even though he might not have been
12 free to explain to the Union the underlying reasons for his
13 opinion. (Tr. p. 69, lines 18-20; p. 122, line 20 - p. 123,
14 line 6; p. 130, line 24 - p. 131, line 15; p. 132, line 4 -
15 p. 133, line 9; p. 135, line 1 - p. 136, line 23; p. 137,
16 lines 11-19.) Accordingly, since the only relevant question
17 from the Union's standpoint was whether the P&L's previously
18 supplied to the Union were fair presentations, the underlying
19 details were irrelevant insofar as the Union was concerned.

20 3. The Board contends (Board's Br., p. 14) that if,
21 after examining the Company's financial records, Mr. Steres
22 had concluded that the Company's inability-to-pay claim was
23 unjustified because the P&L's did not accurately reflect the
24 Company's financial condition, he would have been prevented
25 from informing the Union of this fact.

26 In the first place, this is not a correct statement

1 by the Board either of the Company's offer or of Mr. Steres'
2 testimony. He testified to the contrary, and said that he
3 could have given a negative opinion (Tr. p. 131, lines 6-15;
4 p. 132, line 4 - p. 133, line 8; p. 135, line 24 - p. 136,
5 line 23), and the Company's offer certainly permitted him to
6 do so (G.C. 3(f)).

7 In the second place, this contention by the Board
8 based upon the speculation that Mr. Steres' audit might have
9 resulted in his conclusion that the P&L's were not fair pre-
10 sentations of the Company's financial position is assuming
11 facts not in evidence; there is no evidence of any kind that
12 the P&L's were anything other than fair presentations in
13 every way. The General Counsel has never contended to the
14 contrary, has introduced no evidence to the contrary, and
15 has not even attempted to prove to the contrary. The P&L's
16 given by the Company to the Union remain unchallenged, and
17 the General Counsel made no effort whatsoever to challenge
18 them, either by subpoenaing the Company's records or other-
19 wise, and it is fair to assume that if the General Counsel
20 seriously contended that the P&L's were erroneous, he at
21 least would have attempted to impeach them.

22 4. As shown by Mr. Steres' testimony (see Appendix
23 hereto), many of the matters he would have audited (and which
24 the Company agreed he had carte blanche to audit) were
25 matters of management discretion; the law is clear that the
26 details of such management discretion are irrelevant to the

1 collective bargaining process (the Board concedes this,
2 Board's Br., pp. 14, 17-18) and hence it is irrelevant that
3 Mr. Steres would have been restricted from divulging such
4 details to the Union.

5 5. As shown by Mr. Steres' testimony (see Appendix
6 hereto), many of the matters he would have audited (and which
7 the Company agreed he had carte blanche to audit) included
8 his obtaining knowledge of the identity of the Company's
9 suppliers and customers; the law is clear that such details
10 are irrelevant to the collective bargaining process (Fruit &
11 Vegetable Packers v. NLRB, 316 F. 2d 389, 390-391 (D.C. Cir.
12 1963); Board's Br., p. 20, footnote 6) and hence it is
13 irrelevant that Mr. Steres would have been restricted from
14 divulging such details to the Union.

15 6. It is almost inconceivable that the Company would
16 have agreed (as it did) to permit a carte blanche audit by
17 Mr. Steres if the profit and loss statements previously given
18 to the Union had been false or misleading; thus, the offer by
19 the Company to permit the carte blanche audit by Mr. Steres
20 was in itself a demonstration that the inability-to-pay claim
21 was made in good faith, and a disclosure of the details of
22 the Company's records to the Union (as distinguished from to
23 Mr. Steres) is wholly irrelevant to this good faith.

24

25

26

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

III

CONCLUSION

The only question in this case is whether, under all the circumstances, the Company put forth its inability-to-pay claim in good faith.

Since the Company attempted to substantiate this claim by permitting a carte blanche audit of its books, it is irrelevant that the details of the Company's financial records could not be disclosed to the Union. The Board's contention that such disclosure to the Union should be required is a "straw man", and diverts attention from the key question. The Company's good faith, which is the only question involved, is not measured by whether it was willing (which it was not) to bare its books to the Union, but by whether it was willing (which it was) to bare its books to an independent Certified Public Accountant who had complete freedom to establish the proof of the Company's representations of its financial position.

Under the relevant rule of law, the Company met every obligation of good faith bargaining, and the National Labor Relations Board should be reversed.

DATED: October 10, 1966

Respectfully submitted,

SHEPPARD, MULLIN, RICHTER & HAMPTON

By 

FRANK SIMPSON
Attorneys for Petitioner

- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- 13
- 14
- 15
- 16
- 17
- 18
- 19
- 20
- 21
- 22
- 23
- 24
- 25
- 26

2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

- 13
14
15
16
17
18
19
20
21
22
23
24
25
26

- 16
17
18
19
20
21
22
23
24
25
26

- 19
20
21
22
23
24
25
26

- 22
23
24
25
26

26

1 5. Comparison by him of discretionary Company
2 expenses for the three years in question with prior
3 years (Tr. p. 68, lines 15-24);

4 6. Evaluation by him as to whether management's
5 judgement was right or wrong in the exercise of dis-
6 cretion as to the handling of bad debts (Tr. p. 68,
7 line 25 - p. 69, line 7; p. 89, line 7 - p. 92, line 7);

8 7. Evaluation by him as to whether management's
9 judgement was right or wrong in the exercise of dis-
10 cretion as to the handling of depreciation (Tr. p. 69,
11 lines 8-11);

12 8. Examination by him of the Company's general
13 ledger (Tr. p. 72, line 22 - p. 75, line 1; p. 76,
14 lines 7-18);

15 9. Inventory by him of material and supplies
16 (Tr. p. 76, lines 22-24);

17 10. Determination by him of the inventory method
18 used by the Company (Tr. p. 77, lines 1-3);

19 11. Determination by him of how the Company accumu-
20 lated the costs that go into inventory (Tr. p. 77,
21 lines 3-4);

22 12. Determination by him of whether the Company
23 used the same inventory method in each year in question
24 (Tr. p. 77, line 4 - p. 79, line 16);

25 13. Evaluation by him of management's judgement as
26 to the useful life of an asset for which depreciation

1 is taken (Tr. p. 81, lines 3-21);

2 14. Evaluation by him of management's judgement as
3 to the choice of depreciation method used (Tr. p. 81,
4 line 22 - p. 82, line 14);

5 15. Examination by him of equipment records to
6 determine the type of equipment the Company had, the
7 original cost, and the life being used in writing off
8 the cost (Tr. p. 82, lines 18-22);

9 16. Examination by him of productive asset
10 accounts, and the related repair and maintenance, so as
11 to evaluate management's judgement in allocating between
12 current expenses and capitalization (Tr. p. 83, line 18-
13 p. 84, line 16; p. 86, line 18 - p. 87, line 20);

14 17. Evaluation by him of management's judgement in
15 expensing or capitalizing research and development
16 costs (Tr. p. 85, line 3 - p. 86, line 6);

17 18. Evaluation by him of management's judgement as
18 to whether new products will be productive assets
19 (Tr. p. 85, line 21 - p. 86, line 12);

20 19. Evaluation by him as to whether there are
21 persons on the payroll getting salaries who perform
22 very minor or no duties (Tr. p. 88, line 1 - p. 89,
23 line 6);

24 20. Determination by him as to whether the Company
25 was delinquent in its payroll taxes (Tr. p. 92, lines
26 12-25);

1 21. Evaluation by him of management's judgement as
2 to advertising expenses and the type of advertising
3 undertaken (Tr. p. 93, lines 1-14);

4 22. Determination by him of the relationship of
5 commissions to salaries and wages, of to whom commissions
6 were paid, and of the services performed therefor
7 (Tr. p. 93, lines 15-22);

8 23. Inquiry by him as to the Company's sources of
9 supply and whether or not these sources were affiliated
10 or otherwise controlled operations (Tr. p. 104, lines
11 16-20);

12 24. Inquiry by him into the contract terms between
13 the Company and its salesmen⁴ (Tr. p. 105, lines 13-16);

14 25. Comparison by him of salesmen's present commis-
15 sions to past commissions (Tr. p. 105, line 22 - p. 106,
16 line 5);

17 26. Correspondence by him with debtors to determine
18 if the amount of accounts receivable were correct
19 (Tr. p. 107, lines 1-3);

20 27. Examination by him of the Company's property
21 tax bills (Tr. p. 107, lines 3-4);

22 28. Inquiry by him as to sales generated by each
23 salesman (Tr. p. 109, lines 13-15);

24
25 ⁴ The Company's salesmen are not part of the
26 collective bargaining unit represented by the Union
(TXD, p. 2, lines 30-35.)

1 29. Inquiry by him into salesmen's expenses
2 (Tr. p. 109, lines 21-25);

3 30. Complete familiarization by him with the
4 Company's financial records (Tr. p. 114, lines 13-19);

5 31. Determination by him as to whether advertising
6 expense was materially greater or lesser than in prior
7 years and, if so, a determination as to the reasons
8 therefor (Tr. p. 115, lines 11-15);

9 32. Inquiry by him into the type of advertising
10 campaign carried on by the Company (Tr. p. 115, lines
11 22-24);

12 33. Evaluation by him of management's judgement as
13 to whether costs of brochures should have been expensed
14 or should have been inventoried and carried forward
15 (Tr. p. 116, lines 3-9);

16 34. Examination by him of (Tr. p. 117, line 20 -
17 p. 121, line 13):

- 18 a. The general ledger;
- 19 b. The cash account;
- 20 c. The accounts receivable account;
- 21 d. The machinery and equipment account;
- 22 e. The sales account;
- 23 f. The expense account;
- 24 g. The cash receipts journal;
- 25 h. The cash disbursements journal;
- 26 i. The check record;

- j. The payroll journal;
- k. The sales journal, showing each sale by customer's name;
- l. The purchases journal, showing vendors;
- m. The general journal;
- n. Cancelled checks;
- o. Vouchers from vendors;
- p. Time cards and timekeeping records;
- q. Sales invoices;
- r. Purchases invoices;
- s. Inventory records;
- t. Shipping documents;
- u. Salary contracts;

35. Ascertainment by him of the Company's suppliers
(Tr. p. 122, lines 16-19)

CERTIFICATE OF SERVICE

I, the undersigned, say that I am and was at all times herein mentioned a citizen of the United States and a resident of the County of Los Angeles, State of California, over the age of 18 years and not a party to the within action; that my business address is 458 South Spring Street, Los Angeles, California 90013; that on 10 October, 1966, I served PETITIONER'S REPLY BRIEF dated October 10, 1966, on the below-named counsel in said action, by depositing true copies thereof, enclosed in sealed envelopes with postage thereon fully prepaid, in a mail-box regularly maintained by the United States Government at 458 South Spring Street, Los Angeles, California, addressed as follows:

General Counsel
National Labor Relations Board
21st Region
849 South Broadway
Los Angeles, California 90014
Attention: George A. Pappy, Esquire

Alfred M. Klein, Esquire
Messrs. Rose, Klein & Marias
315 West Ninth Street
Los Angeles, California 90015
(on behalf of International Brotherhood of
Operative Potters, AFL-CIO)

Plato E. Papps, Esquire
1300 Connecticut Avenue
Washington 6, D. C.
(on behalf of International Brotherhood of
Operative Potters, AFL-CIO)

.....

.....

.....

1 and three copies of the above-named documents to:

2 Marcel Mallet-Prevost, Esquire
3 Assistant General Counsel
4 National Labor Relations Board
5 Washington, D. C. 20570

6 I declare under penalty of perjury that the
7 foregoing is true and correct.

8 Executed on 10 October, 1966 at Los Angeles,
9 California.

10
11 *Carol Ann Parco*
12 _____

13 Carol Ann Parco
14
15
16
17
18
19
20
21
22
23
24
25
26

United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al.*, *Petitioners*,

vs.

FEDERAL MARITIME COMMISSION and UNITED STATES
OF AMERICA, *Respondents*.

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

BRIEF OF PETITIONERS

EDWARD G. DOBRIN

STANLEY B. LONG

ARTHUR G. GRUNKE

Attorneys for Petitioners

FILED

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG

Of Counsel

Office and Post Office Address:

14th Floor Norton Building

Seattle, Washington 98104

NOV 12 1955

FRANK H. SCHMID, CLERK

United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al.*, *Petitioners*,

VS.

FEDERAL MARITIME COMMISSION and UNITED STATES
OF AMERICA, *Respondents*.

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

BRIEF OF PETITIONERS

EDWARD G. DOBRIN
STANLEY B. LONG
ARTHUR G. GRUNKE
Attorneys for Petitioners

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG
Of Counsel

Office and Post Office Address:
14th Floor Norton Building
Seattle, Washington 98104

SUBJECT INDEX

	<i>Page</i>
Jurisdiction	1
Statement of the Case.....	1
Specification of Errors and Points Relied Upon.....	5
Argument	6
I. The Renewed Motion to Reopen.....	6
II. The Rate of Return in the Seasonal Service....	14
A. Error in Allocation of Administrative and General Expense.....	14
B. Error in Deduction of Interest in Determining Federal Income Tax.....	15
C. Error in Treatment of Charter Opera- tion of Vessel TALKEETNA.....	17
III. The August 19, 1965, Order Results in Con- fiscation, Deprivation and Taking of Prop- erty of Alaska Steam for Public Use Without Due Process of Law and Without Just Com- pensation, Contrary to and in Violation of the Fifth Amendment to the Constitution of the United States.....	20
Conclusion	25
Appendix	1a
Table of Exhibits.....	1a
Schedule 1.....	2a
Schedule 2.....	3a
Schedule 3.....	3a
Schedule 4.....	4a

TABLE OF CASES

<i>Alaska Steamship Co. v. Federal Maritime Comm.</i> , 344 F.2d 810, April 15, 1965, File No. 19297.....	2
<i>American Trucking Assos. v. United States</i> , 344 U.S. 298 (1953).....	24

<i>Baltimore & O. R. Co. v. United States</i>	
298 U.S. 349 (1936).....	21, 24
<i>Green Spring Dairy v. Commissioner of Internal</i>	
<i>Rev.</i> , 208 F.2d 471, 475 (4 Cir., 1953).....	13
<i>New York v. United States</i> , 331 U.S. 284 (1947).....	23

CONSTITUTIONAL PROVISIONS AND STATUTES

Fifth Amendment to the Constitution of the	
United States	20
Administrative Procedure Act. §5(a) (b) (Title 5,	
U.S.C.A. §1004(a) (b))	13
Judicial Review Act. §2 (Title 5 U.S.C.A.,	
Chap. 19A, §1032)	22
Judicial Review Act, §7(c) (Title 5, U.S.C.A.,	
Chap. 19A, §1037(c)	20

United States Court of Appeals

For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al.*,
Petitioners,

vs.

FEDERAL MARITIME COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

No. 20351

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

BRIEF OF PETITIONERS

This is a review of the August 19, 1965 Order¹ of the respondent, Federal Maritime Commission, entered in a rate investigation pending before the Commission in its consolidated dockets Nos. 969 and 1067.

JURISDICTION

The existence of this Court's jurisdiction appears from the allegations of paragraphs II, III and IV of the Petition for Review.

STATEMENT OF THE CASE

The August 19, 1965 Order was entered by the Commission following this Court's decision and decree in a prior review proceedings setting aside the Commission's two prior orders in said consolidated dockets and

¹ Exhibit A to the Petition for Review.

remanding the proceedings to the Commission (*Alaska Steamship Co. v. Federal Maritime Comm.*, 344 F.2d 810, April 15, 1965, File No. 19297).

Alaska Steam² is a common carrier by water, serving Alaska, principally to and from Puget Sound ports. This service is referred to as the overall Alaska operation and consists of a so-called scheduled service and a so-called seasonal service.³

On December 18, 1961 Alaska Steam filed with the Commission so-called Company rates increasing rates on cannery supplies and canned salmon moving in both the scheduled and seasonal services and on all other commodities moving in the seasonal service. The Commission suspended these rates and entered on an investigation in said consolidated dockets. The rates became effective on May 18, 1962 following the expiration of the suspension and have since continued in effect. This Commission's investigation resulted in the orders which were set aside in the prior review proceedings. In the first of these orders, March 5, 1964 Order, the Commission found that the Company rates produced a rate of return of 19.75% in the seasonal service based on the test period used by the Commission, November, 1961 through October, 1962, as adjusted, and that they were unjust and unreasonable to the extent that they

²Alaska Steam, as in the prior review proceedings, will be referred to as though it were the only petitioner.

³The same terms will be here used as were used by petitioners in the prior review proceedings.

produced a rate of return in excess of 10%. In the second of these orders, May 12, 1964 Order, the Commission denied a motion to reopen the investigation to receive evidence of the actual results of the seasonal service for the years 1962 and 1963. Alaska Steam asserted that the Company rates were in compliance with the March 5, 1964 Order as they were not actually producing a rate of return in excess of 10% and that further increased rates were justified due to losses being incurred in the seasonal service. The Commission in denying the motion to reopen stated that amended tariffs were to be filed which "must clearly set forth decreases, not increases" and ordered the filing of tariffs naming lesser percentage increases, which it found were the "maximum fair and reasonable increases" permissible, being the so-called Commission rates.

In the prior review proceedings this Court found that the Commission erred in its determination of the Federal income tax to be deducted as an expense in arriving at net profit and rate of return in the seasonal service and further that the Commission had failed to disclose "the basis" on which the Commission rates were computed and the "reasons for selecting that basis" making it necessary to remand the proceedings for "findings and conclusions" on the matter. This Court further held that Alaska Steam should be permitted to renew its motion to reopen the investigation "to receive later operating figures" and that such a renewed motion should not be denied by the Commission unless there

were "considerations not drawn to our attention which would warrant such a denial." Alaska Steam filed such a renewed motion to reopen.⁴

In the August 19, 1965 Order the Commission denied the renewed motion to reopen, redetermined the Federal income tax to be deducted as an expense in arriving at net profit in the seasonal service at the Company rates based on the test period and found the rate of return to be 13.97%, not 19.75% as it had previously erroneously found. The Commission in the August 19, 1965 Order did not attempt either by findings or conclusions to justify the Commission rates or to order that they be put into effect, but required the filing of decreased rates which would have produced a rate of return of not to exceed 10% in the seasonal service based on the test period. The Commission does not attempt to prescribe how this end result is to be accomplished, namely, whether all of the Company rates, or only some, are to be decreased and, in either event, whether the decrease is to be on some uniform basis or formula or whether the decreases may vary as between commodities. Concededly these decreased rates ordered by the Commission are in no way to be based on existing or anticipated future operating data. This, despite the showing made to the Commission in the motion to reopen and in the renewed motion to reopen that the seasonal service operated at a loss in 1963 and 1964.

⁴Exhibit B to Petition for Review.

**SPECIFICATION OF ERRORS AND POINTS
RELIED UPON**

The Commission in entering its August 19, 1965 Order was arbitrary and capricious, abused its discretion and erred in the following respects:

1. In denying the renewed motion to reopen and thereby failing to comply with this Court's decision and decree in the prior review proceedings.

2. In failing to grant Alaska Steam a hearing on the renewed motion to reopen, thereby depriving it of due process of law, contrary to and in violation of the Fifth Amendment to the Constitution of the United States and the procedural requirements of the Administrative Procedure Act.

3. In ordering the filing of decreased rates, resulting in confiscation, deprivation and taking of property of Alaska Steam for public use without due process of law and without just compensation, contrary to and in violation of the Fifth Amendment to the Constitution of the United States.

4. In determining the amount of administrative and general expense to be allocated to the seasonal service under the formula approved by this Court, resulting in an erroneous determination of the rate of return in the seasonal service.

5. In giving effect to an item of \$13,015 interest as a deduction in the process of determining the Federal

income tax applicable to the seasonal service, resulting in an erroneous determination of the rate of return in the seasonal service.

6. In failing to treat the charter operation of the vessel TALKEETNA as a part of the seasonal service, resulting in an erroneous determination of the rate of return in the seasonal service.

ARGUMENT

I.

The Renewed Motion to Reopen (Specification of Errors 1 and 2)

Alaska Steam in its renewed motion to reopen filed with the Commission requested an opportunity to be heard if the Commission “deems that there are or may be considerations not drawn to the attention of the Court of Appeals * * * adversely affecting the granting of this petition.” In response to this motion the Commission’s Hearing Counsel stated that petitioners were proceeding “in conformity with the decision rendered by the Court of Appeals” and that the Court had directed “that the Commission reopen the proceedings to receive later operating figures of Alaska Steam unless there were other considerations not drawn to the Court’s attention which would warrant a refusal to consider these figures.” Hearing Counsel acquiesced in the reopening and stated:

“The Court was aware that receipt of these figures would necessitate remanding the matter to an examiner with attendant delay as well as the necessity of closing a regulatory proceeding in timely

fashion. Hearing Counsel are not aware of any other considerations which would justify such refusal.”

The August 19, 1965 Order was entered without notice to or giving Alaska Steam an opportunity to be heard.

The Commission’s reasons for denying the renewed motion to reopen are stated as follows:

“The Commission is of the opinion that an amplification of the reasons advanced to the Court of Appeals in support of the argument that denial of Alaska Steam’s previous petition to reopen was not an abuse of discretion coupled with considerations not drawn to the Court’s attention warrant the denial.” (p. 2)

The Commission is not in a position to argue that its denial of the “previous petition to reopen was not an abuse of discretion.” This argument has been foreclosed by this Court’s decision in the prior review proceedings. The Commission was unsuccessful in those proceedings in having this Court hold that its denial of the previous motion to reopen was not arbitrary and capricious and should not be set aside. The Commission filed a Petition for Rehearing in the prior review proceedings but did not in such petition assert that this Court was in error or seek any modification of this Court’s decision in this respect. This Court’s prior disposition of this matter is final and conclusive and is no longer subject to reargument by way of “amplification” or otherwise.

The further lapse of time since the original denial of

the motion to reopen and the continued loss being sustained in the seasonal service⁵ furnishes additional support to this Court's statement in its decision that the 1962 test period "has less and less to recommend it as a reliable basis upon which to predicate a prospective rate order." This further demonstrates that the Commission's action in denying the renewed motion to reopen is arbitrary and capricious and an abuse of discretion.

The Commission, however, uses its August 19, 1965 Order to reargue the matter, stating in effect (1) that a reopening would necessitate remanding the matter to an examiner with attendant delay, and (2) that this would not be consistent with the necessity of closing a regulatory proceeding in timely fashion. The Commission relies on numerous authorities in support of its reargument, all of which were cited to this Court by the Commission in the prior review proceedings.⁶ The Commission in the prior review proceedings both orally and in writing argued on the basis of these authorities and others that denial of reopening was justified because it would necessitate remanding the matter to an examiner with attendant delay and that this would not be consistent with the necessity of closing a regulatory proceeding in timely fashion.⁷ This Court in its decision

⁵Ex. B (Affidavit of J. F. Zumdieck) to Application for Temporary Stay and Suspension.

⁶Brief of Respondents, pp. 18, 19, 20, and Respondents' Memorandum in Opposition to the Application to Adduce Additional Evidence, pp. 4, 5 and 6.

⁷May 12, 1964 Order, pp. 2, 3 and Respondents' Memorandum in Opposition to the Application to Adduce Additional Evidence, pp. 7, 8.

specifically referred to the Commission's position in reference to the recomputation of a rate of return based on later operating results stating:

"The Commission points out, however, that no matter how simple such a computation might have been, it could not have been accomplished without remanding the proceeding to the examiner, with all of the attendant delays this would involve. The Commission argues that in the interest of bringing an end to the investigation and getting an agency rate order into effect, the Commission was warranted in denying the motion to reopen."

If the Commission considered that this Court was in error in not approving its denial of the motion to reopen it could have and apparently did consider filing a petition for a writ of certiorari. For that purpose the Commission secured from this Court an order staying issuance of judgment which was subsequently dissolved on the Commission's motion. In conformity with this Court's opinion, the Commission should have granted the renewed motion to reopen unless there were present considerations not drawn to this Court's attention which warranted denial.

What then are the asserted considerations which the Commission states were "not drawn to the Court's attention" and which "warrant the denial" of the renewed motion to reopen? The Commission states:

"In our opinion, the most important consideration in our determination of Alaska Steam's petition is the conduct of the carrier itself coupled with the remedies available to it." (p. 4)

The conduct of the carrier referred to is stated to be that although claiming that the results of its operations subsequent to November, 1962 have been disastrous, Alaska Steam "has filed no new increases since December of 1961" although it "has been free at any time to file new rates based on changed operating results, despite the pending proceedings" (p. 5). The Commission states that the proper procedure for Alaska Steam "is to file new rate increases with the Commission if in its opinion such increases are warranted" which "subsequent rate filing would thus create a 'locked-in' period for the Commission's determination" in a "new rate proceeding in which Alaska Steam will be free to introduce any evidence of past operating results and future projections." The Commission has overlooked the fact that in its May 12, 1964 Order it stated:

"Respondents may not submit tariffs which increase the rates because they claim that the year-end 1962 figures and the 1963 figures prove a different result. The amended tariffs must clearly set forth decreases, not increases." (pp. 3, 4)

The August 19, 1965 Order similarly requires the filing of tariffs setting forth decreases, not increases.

The Commission also overlooked or ignored the fact that Alaska Steam was likewise free to review the Commission orders, including the denial of the motion to reopen. Clearly Alaska Steam should not suffer a denial of its renewed motion to reopen for having been successful on the review of the prior Commission or-

ders. As a result of the prior review proceedings the Commission was required to review its findings and as noted above has now found in the August 19, 1965 Order that based on the operating data used for the test period the net profit of the seasonal service produced a rate of return of 13.97%, not 19.75% as erroneously determined in the March 5, 1964 Order. Alaska Steam proposes to show that this later finding of rate of return is likewise erroneous.

The considerations relied upon by the Commission were in fact drawn to this Court's attention by the Commission in the prior review proceedings. It might be added that inasmuch as the considerations referred to by the Commission have their basis in law and not in fact, they must be assumed to have been as well known to this Court as to the Commission. In any event, they were specifically called to this Court's attention by the Commission in substantially the same manner as expressed in the August 19, 1965 Order. Aside from being urged at the oral argument, these considerations were presented by the Commission in writing on two separate occasions, the first in Respondent's Memorandum in Opposition to the Application for Interlocutory Injunction wherein the Commission stated:

“ * * * the Court must consider the consequences to the public interest and particularly to the conduct of administrative proceedings should the injunction be granted. For, if petitioners are successful in obtaining an injunction against the ef-

fectiveness of the Commission's orders, the administrative process will have been finally and completely frustrated. Petitioners should, if they find that new increases are warranted by new data, file such increases with the Commission, rather than bring the new data before this Court in a petition to review a proceeding already concluded. There is nothing to prevent petitioners from filing such increases on the statutory thirty days notice, although such a course of action is unlikely unless their plea for an injunction is refused⁴." (p. 11) ["⁴Because the Commission can after complaint or *sua sponte* suspend the increases for four months."]

The second occasion was in Respondents' Memorandum in Opposition to the Application to Adduce Additional Evidence where the Commission stated:

" * * * if petitioners' actual experience *subsequent* to the closing of the record suggests to them that they would not be able to make a proper return under the authorized rates, their proper remedy is to file new tariffs pursuant to 46 USC 844, and establish, on the basis of a new record, the lawfulness of their rates." (p. 9)

If the Commission was of the view that this Court had not sufficiently considered these matters in arriving at its decision it could have, but did not, specify this in its Petition for Rehearing. Petitioners conclude, as does the Commission's Hearing Counsel, that all of the matters reargued by the Commission were called to this Court's attention in the prior review proceedings and that in rendering its decision and entering its decree this Court was fully aware of and considered all of such matters. The Commission has failed to point out any considerations which were not drawn to this

Court's attention which would warrant a denial of the renewed motion to reopen.

The entry of the August 19, 1965 Order denying the renewed motion to reopen without granting the hearing requested by Alaska Steam was violative of Alaska Steam's constitutional right to due process of law under the Fifth Amendment to the Constitution of the United States and in violation of the procedural requirements of the Administrative Procedure Act, § 5 (a) (b).⁸

In *Green Spring Dairy v. Commissioner of Internal Rev.*, 208 F.2d 471, 475 (4 Cir., 1953), the Court citing decisions of the Supreme Court, announces the established rule as follows:

“ * * * opportunity to present a case and to be heard is fundamental to the validity of proceedings by administrative tribunals * * *. In many decisions it has been held that the right to due notice * * * and an opportunity to be heard * * * are assured to every litigant by the Federal Constitution.”

The Commission having failed to point out any considerations not drawn to this Court's attention which would warrant a denial of the renewed motion to reopen, this cause should be remanded to the Commission with instructions to grant the motion.

⁸Title 5, U.S.C.A. § 1004(a) (b). “In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing * * *. (a) Persons entitled to notice of * * * hearing shall be timely informed * * *. (b) The agency shall afford all interested parties opportunity for * * * hearing * * *.”

II.**The Rate of Return in the Seasonal Service****A. Error in Allocation of Administrative and General Expense.****(Specification of Errors 4)**

Alaska Steam allocated administrative and general expense on the basis of actual vessel days (Ex. 3-B-5, sheet 2). This Court, in the prior review proceedings, approved the formula adopted by the Commission for allocating general and administrative expense, namely, "in the proportion that the total vessel operating expense of each service bears to the total vessel operating expense." On the method adopted by Alaska Steam the amount of \$35,712 was allocated to the charter operation of the vessel TALKEETNA, referred to as the "Off-shore" or "Other" operation. In applying the formula approved by this Court the Commission in the August 19, 1965 Order did not correct this allocation made to the charter operation, but merely allocated the balance of the administrative and general expense in the amount of \$1,625,330 (\$1,661,042 less \$35,712) between the scheduled and seasonal services on the formula approved by this Court. The proper method of allocation is as shown on Schedule 1.⁹ This results in an increase of \$5,054 in the administrative and general expense to be allocated to the seasonal service under the method approved by this Court. Correcting only for this error in the allocation of administrative and general ex-

⁹This Schedule and other Schedules referred to in this brief appear in the appendix.

pense, the rate of return in the seasonal service at the Company rates based on the test period is reduced from 13.97% as now found by the Commission to 13.24% (Schedule 2, Col. A).

B. Error in Deduction of Interest in Determining Federal Income Tax.

(Specification of Errors 5)

In the Commission's recalculation of the Federal income tax applicable to the seasonal service an item of interest of \$13,015 has been deducted from the gross profit used in determining the Federal income tax, a portion of which is allocated to the seasonal service. This is interest paid by Alaska Steam during the test period on vessel mortgages, which was disallowed as an expense by the Commission in its determination of the gross profit for rate making purposes. This item was not deducted by the Commission in its prior calculation of Federal income tax and should not now be deducted. The Commission does not disclose the basis on which this deduction is made or the reasons therefor.

Presumably the Commission will assert that although such interest is not to be allowed in determining the rate of return earned by Alaska Steam, it is nevertheless to be deducted in the calculation of Federal income tax. The error in any such contention is that the Commission is not attempting to determine the actual Federal income tax of Alaska Steam, but is only concerned with the determination of such expenses, including taxes, deemed allowable in rate proceedings to deter-

mine profit and the ultimate question of rate of return. Inasmuch as such interest is not allowable as an expense in determining Alaska Steam's profit for rate making purposes, it is improper to include it as a deduction in determining its theoretical Federal income tax, otherwise a pure happenstance having no bearing on the validity of rates is permitted to affect rates.

It is immaterial so far as the determination of profit in a rate proceeding is concerned whether Alaska Steam has mortgages on its vessels or not. If it does have such mortgages it is likewise immaterial whether it does or does not pay interest thereon and in what amount. If Alaska Steam paid the principal of the mortgages, thus relieving itself of interest expense, the propriety of rates charged by it for its services would be in no way affected. Likewise, if it does not pay the mortgages or increases the amount thereof and continues to pay interest or increased interest thereon, this also has no bearing on the propriety of its rates. If the rates of two companies in the same trade were being tested it would certainly be improper to permit the difference in their interest obligations on mortgages on vessels to affect the propriety of their respective rates.

Interest is a cost of acquiring capital but such cost is neither included in the rate base nor in expense in a rate proceeding. Inasmuch as it is apparent that the Commission has not and cannot justify the treatment given to this item of interest in calculating the Federal

income tax, such tax should be calculated on the gross profit without reference to such interest. Correcting for this error¹⁰ the rate of return in the seasonal service at the Company rates based on the test period is reduced from 13.97% as found by the Commission to 12.85% (Schedule 2, Col. B).

C. Error in Treatment of Charter Operation of Vessel *Talkeetna*.

(Specification of Errors 6)

During the test period the vessel TALKEETNA, employed exclusively in the seasonal service, was assigned to an off-shore charter voyage of 77 days while not required in the seasonal service. The purpose of this charter operation was to eliminate the layup expense which would otherwise have been chargeable to the seasonal service and to give the seasonal service the benefit of any operating profit (Tr. 205, 442, 989, 990).¹¹ The charter operation resulted in an operating profit of \$21,270 (Ex. 3-B-5, sheet 2). There was no increase in the depreciation chargeable to this vessel by reason of the charter operation and no increase in total administrative and general expense. The Commission allocated depreciation of \$8,706 to the vessel while engaged in the charter operation and \$35,712 of the total

¹⁰ In addition to correcting for the error in the allocation of administrative and general expense.

¹¹ Tr. refers to the pages of the record of testimony in the proceedings before the Commission.

administrative and general expense.¹²

Alaska Steam asserts that the charter operation should not be considered as a separate service but should be considered as a part of the seasonal service to determine the profit of the seasonal service. The Commission did not include the charter operation as a part of the seasonal service but did include it as an alleged loss operation in determining the Federal income tax applicable to the seasonal service.

If there had been no charter operation the seasonal service would have been charged with the layup expense of the vessel during the charter period as well as with the depreciation of the vessel charged to the charter operation and with the portion of the administrative and general expense to be properly allocated to the charter operation and it would not have had the benefit of the \$21,270 operating profit. The Commission in its treatment of the charter operation ignores these facts. If the charter operation is included as a part of the seasonal service that service is to be credited with the operating profit and charged with the properly assigned depreciation and administrative and general expense resulting in a deduction of \$1,787 in the gross profit of the seasonal service.¹³

If the charter operation were included as a part of the seasonal service the rate of return in that service

¹² The allocated portion of the administrative and general expense should have been \$14,351 (Schedule 1, *supra* p. 14).

¹³ Schedule 1.

at the Company rates would have been 12.74% based on the test period.¹⁴ If none of the other adjustments taken into consideration in Schedule 3 were made the rate of return would have been 12.23% (Schedule 4). The Commission does not disclose the basis for its treatment of the charter operation of the vessel TALKEETNA nor the reasons therefor and such treatment is not justified by the facts.

The combined operating revenue and vessel operating expense in the seasonal service, based on the test period, was \$7,954,792 (Ex. 3-B-5, sheet 1). Giving effect to the adjustments made in Schedule 3, the excess net profit was but \$42,676 (\$197,958 less \$155,282) or slightly in excess of one-half of 1% of such combined revenue and expense. Giving effect to the adjustments made in Schedule 4 the excess net profit was but \$34,630 (\$189,912 less \$155,282) or less than one-half of 1% of such combined revenue and expense. It can thus be readily seen that a slight decrease in revenue or increase in expense, or both, could result in a loss operation such as in fact resulted in 1963 and 1964 as disclosed by Alaska Steam to the Commission in its unsuccessful efforts to secure a reopening of the Commission's investigation.

¹⁴ Schedule 3. This schedule likewise adjusts for the errors in the allocation of administrative and general expense and in the deduction of interest in the process of determining Federal income tax.

III.

The August 19, 1965 Order Results in Confiscation, Deprivation and Taking of Property of Alaska Steam for Public Use Without Due Process of Law and Without Just Compensation, Contrary to and in Violation of the Fifth Amendment to the Constitution of the United States.

(Specification of Errors 3)

The Fifth Amendment to the Constitution of the United States provides:

“No person shall be * * * deprived of * * * property, without due process of law; nor shall private property be taken for public use, without just compensation.”

Alaska Steam's Application for Leave to Adduce Additional Evidence filed in these review proceedings, is for the purpose of vindicating the claim of Alaska Steam that the Commission's August 19, 1965 Order deprives it of its property for public use without due process of law and without just compensation, contrary to its rights under the Fifth Amendment to the Constitution of the United States.

The Judicial Review Act, § 7(c) (Title 5 U.S.C.A., Chap. 19A, § 1037(c)) provides that the reviewing court may order additional evidence to be taken by the administrative agency if it is shown to the satisfaction of the Court “that such additional evidence is material, and * * * that there were reasonable grounds for failure to adduce such evidence before the agency.”

The Commission, by its August 19, 1965 Order, re-

quired Alaska Steam to put decreased rates in effect in the seasonal service, which rates Alaska Steam asserts are confiscatory not only as to the present but also as to the past and future. The Commission, in its May 12, 1964 Order, documented its refusal to receive evidence on the issue of confiscation, as follows:

“The Examiner refused * * * to hold the record open until final figures of 1962 could be submitted * * *. * * * we rejected * * * request to submit additional data last November, and again reject it now.”

By its August 15, 1965 Order the Commission followed its prior procedure and denied the renewed motion to reopen for the purpose of receiving in evidence additional operating figures. It clearly appears from the record before this Court that the data which petitioners unsuccessfully sought to produce before the Commission showed that the seasonal service would have produced noncompensatory results in 1962 at the decreased rates ordered by the Commission and that in 1963 and 1964 the seasonal service operated at a loss even at the Company rates in effect, which loss would have been increased had the decreased rates ordered by the Commission been in effect.¹⁵

In *Baltimore & O. R. Co v. United States*, 298 U.S. 349 (1936), the Supreme Court stated the basic consti-

¹⁵ Findings of this Court in its Order on Application for Interlocutory Injunction in the prior review proceedings, No. 19297, filed June 2, 1964 and affidavit of J. F. Zumdieck attached as Exhibit B to the Application for Temporary Stay and Suspension.

tutional principle, as announced in earlier cases cited therein, that neither Congress nor a federal regulatory agency has the power to require carriers "to serve the public at rates that are confiscatory." The Court had before it divisions established by the Interstate Commerce Commission which were asserted to be confiscatory. The Court stated that in view of the duties of carriers to the public, when confiscatory rates or divisions are prescribed by a regulatory agency pursuant to statutory authority, this is equivalent to Congressional action "requiring the carriers to serve for the amounts specified" thus expropriating "the use of carriers' property." The Court further stated that when such rates or divisions "are, or later shall become, less than just compensation, the carriers may not be required to serve therefor" (p. 357).

The next question dealt with by the Court was how do affected carriers obtain relief from an order establishing confiscatory rates or divisions. The Court, referring to divisions, stated that "the carriers may by suit in equity have the order prescribing, or requiring to be kept in force, the challenged divisions adjudged void and its enforcement permanently enjoined" (pp. 357, 358). It is to be noted that the jurisdiction to review the August 19, 1965 Order of the Commission is by the Judicial Review Act, § 2 (Title 5 U.S.C.A., Chap. 19A, § 1032) vested exclusively in an appropriate court of appeals.

In connection with such a suit in equity in a district court the Court further stated:

“There is no statute that can be held to limit * * * trial of an issue of confiscation. * * *

“There is a wide and fundamental difference between the question whether the commission, in prescribing divisions found by it to be just, reasonable and equitable, complied with the procedural requirements of the Act, and whether, if enforced against objecting carriers, the order will confiscate their property. The commission’s findings of fact in the field first mentioned, if based on evidence, are conclusive. But, upon the question whether prescribed divisions constitute just compensation within the meaning of the Fifth Amendment, Congress is without power conclusively to bind the carriers. As the Congress itself could not be, so it cannot make its agents be, the final judge of its own power under the Constitution. Congress has no power to make final determination of just compensation or to prescribe what constitutes due process of law for its ascertainment.

“ * * * The just compensation clause may not be evaded or impaired by any form of legislation. * * * The due process clause assures a full hearing before the court or other tribunal empowered to perform the judicial function involved. That includes the right to introduce evidence and have judicial findings based upon it.” (pp. 363, 364, 368 and 369)

In *New York v. United States*, 331 U.S. 284 (1947), it was contended that rates established by the Interstate Commerce Commission were confiscatory and on review in a district court additional evidence on this issue was received. The Supreme Court stated that

“ * * * if the additional evidence was necessary to pass on the issue of confiscation, the cause should have been remanded to the Commission for a fur-

ther preliminary appraisal of the facts which bear on the question.” (p. 336)

The Court pointed out that in *Baltimore & Ohio*, as in the case at bar, the Commission refused to receive evidence proffered on the point of confiscation, whereas in the case then before the Court the Commission received all evidence that was offered. Under such circumstances the Court stated:

“ * * * correct practice requires that, where the opportunity exists, all pertinent evidence bearing on the issues tendered the Commission should be submitted to it in the first instance and should not be received by the District Court as though it were conducting a trial de novo.” (p. 335)

In *American Trucking Assos. v. United States*, 344 U.S. 298 (1953), the Supreme Court again recognizes the constitutional principle stated in *Baltimore & Ohio* relating to agency established rates for carriers and states:

“ * * * that those concerned with an order affecting their just compensation for transportation services must be heard; indeed, their right to introduce evidence to support the claim that the order in question will unconstitutionally confiscate their property may be enforced even in the District Court if the Commission bars an opportunity to do so.” (p. 320)

The Court further states that an order of a regulatory agency establishing rates to be charged by carriers is “said to confiscate property when it prohibits a reasonable return on investment beyond operating and initial costs” (pp. 321, 322).

The Court further states that where the “constitutional right of compensation” is drawn in question:

“ * * * we have admonished the Commission and the courts to permit introduction of evidence on the economic impact of a rate order where the claim that it could not have been proffered during the original proceedings was genuine.” (p. 322)

From the foregoing authorities it becomes manifest that the provisions of the Judicial Review Act, § 7, for the adducing of additional evidence before the agency whose order is under review, permits this Court, under circumstances such as are presented here, to refer to such agency, at least initially, the taking of evidence on the issue of confiscation. The Application for Leave to Adduce Additional Evidence should be granted, reserving to this Court the final determination of the issue of confiscation.

CONCLUSION

The prayer of the Petition for Review should be granted.

Respectfully submitted,

EDWARD G. DOBRIN

STANLEY B. LONG

ARTHUR G. GRUNKE

Attorneys for Petitioners

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG

Of Counsel

Office and Post Office Address:

14th Floor Norton Building

Seattle, Washington 98104

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

EDWARD G. DOBRIN
Attorney

APPENDIX

APPENDIX

EXHIBIT TABLE

<i>Exhibit No.</i>	<i>Identified (Tr.)</i>	<i>Offered (Tr.)</i>	<i>Received (Tr.)</i>
1	21	36	37
2-A-30	45	1157	1162, 1163
3-B-1	55	350	351
3-B-5	55	358	1158, 1162, 1163
3-B-9	55	1158	1158, 1162, 1163
3-B-22	55	1158	1158, 1163
3-B-35	55	350	351
4	86	350	350, 351
5	151	350	350, 351
6	352, 353	397	397
7	357	1297	1297
8	357	397	397
9	357	397	397
10	398	424	424
12	411	424	424
22	860	1297	1297
24	991	1157	1158, 1162

39 (Late Filed Exhibit. R. 29)

SCHEDULE 1

Allocation of Administrative and General Expense Operating Expense (*Ex. 3-B-5, sheet 1*)

	<u>Seasonal</u>	<u>Scheduled</u>	<u>Other</u>	<u>Total</u>
	\$3,425,067	\$11,063,411	\$126,334	\$14,614,8
Per Cent of Total	23.436%	75.700%	.864%	100%

Administrative and General Expense (Ex. 3-B-5, sheet 2)

	<u>Seasonal</u>	<u>Scheduled</u>	<u>Other</u>	<u>Total</u>
	23.436%	75.700%	.864%	100%

Allocated Amount	\$ 389,282	\$ 1,257,409	\$ 14,351	\$ 1,661,0
---------------------	------------	--------------	-----------	------------

Amount Allocated by Commission	384,228	1,241,102	35,712	
--------------------------------------	---------	-----------	--------	--

Adjustment Required in Gross Profit	(5,054)	(16,307)	21,361	
---	---------	----------	--------	--

Gross Profit Found by Commission	360,508	73,372	(23,148)	410,7
--	---------	--------	----------	-------

Adjusted Gross Profit	355,454	57,065	(1,787)	410,7
-----------------------------	---------	--------	---------	-------

EXHIBIT TABLE

SCHEDULE 2

	<i>Col. A</i>	<i>Col. B</i>
Gross Profit	\$355,454	\$355,454
Federal Income Tax	173,463*	179,295**
	<u>\$182,391</u>	<u>\$176,159</u>
Profits related companies	23,461	23,461
Net profit	<u>\$205,852</u>	<u>\$199,620</u>
Rate of Return	13.24%	12.85%

Income tax calculation

	<u>Seasonal</u>	<u>Scheduled</u>	<u>Other</u>	<u>Total</u>
Gross Profit	\$ 355,454	\$ 57,065	\$ (1,787)	\$ 410,732
Rate Cent	86.166%			
Total	410,732		**Total	410,732
Interest	13,015	52% (less \$5,500)		208,081
	<u>\$ 397,717</u>			
% (less \$500)	\$ 201,313			

SCHEDULE 3

Gross Profit	\$355,454
Adjustment	1,787
	<u>\$353,667</u>
Federal Income Tax	179,170*
	<u>\$174,497</u>
Profits related companies	23,461
Net Profit	<u>\$197,958</u>
Rate of Return	12.74%

Income tax calculation

	<u>Seasonal</u>	<u>Scheduled</u>	<u>Total</u>
Gross Profit	\$ 353,667	\$ 57,065	\$ 410,732
Rate Cent	86.106%		
Total	\$ 410,732		
% (less \$5,500)	\$ 208,081		

EXHIBIT TABLE

SCHEDULE 4

Gross Profit	\$360,508
Adjustment	23,148
	<u>\$337,360</u>
Federal Income Tax	170,909*
	<u>\$166,451</u>
Profits Related Companies	23,461
Net Profit	<u>\$189,912</u>
Rate of Return	12.23%

*Income tax calculation

	<u>Seasonal</u>	<u>Scheduled</u>	<u>Total</u>
Gross Profit	\$ 337,360	\$ 73,372	\$ 410,7
Per Cent	82.136%		
Total	\$ 410,732		
52% less \$5,500)	\$ 208,081		

BRIEF FOR RESPONDENTS

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20,351

ALASKA STEAMSHIP COMPANY, ET AL.,

Petitioners,

v.

FEDERAL MARITIME COMMISSION and UNITED STATES OF AMERICA,

Respondents.

ON PETITION FOR REVIEW OF ORDER OF THE
FEDERAL MARITIME COMMISSION

DONALD F. TURNER
Assistant Attorney General

IRWIN A. SEIBEL
Attorney

Department of Justice

M. C. MISKOVSKY
Solicitor

WALTER H. MAYO III
Attorney

Federal Maritime Commission

December 15, 1965
Washington, D. C.

FILED

DEC 15 1965

THOMAS D. BROWN

TABLE OF CONTENTS

	<u>Page</u>
COUNTERSTATEMENT OF THE CASE	1
ARGUMENT	2
I. The Motion To Reopen	2
II. The Income Tax Computation	7
III. The Issue Of Confiscation	9
CONCLUSION	10



TABLE OF CASES CITED

<u>Case</u>	<u>Page</u>
<u>Alaska Steamship Company, Inc., et al. v. Federal Maritime Commission, 344 F.2d 810</u>	1
<u>Baltimore and Ohio Railroad Co. et al. v. United States, et al. 298 U.S. 349 (1936).</u>	9
<u>General Increases in Alaskan Rates and Charges, 7 F.M.C. 563, at 575 (1963).</u>	8
<u>Interstate Commerce Commission v. City of Jersey City, 322 U.S. 503 (1944).</u>	4
<u>Virginia Petroleum Jobbers Association v. Federal Power Commission, 293 F.2d 527, at 529 (D. C. Cir. 1961).</u>	2
<u>Wilson and Co. v. United States, 335 F.2d 788, at 799 (7th Cir. 1964).</u>	2

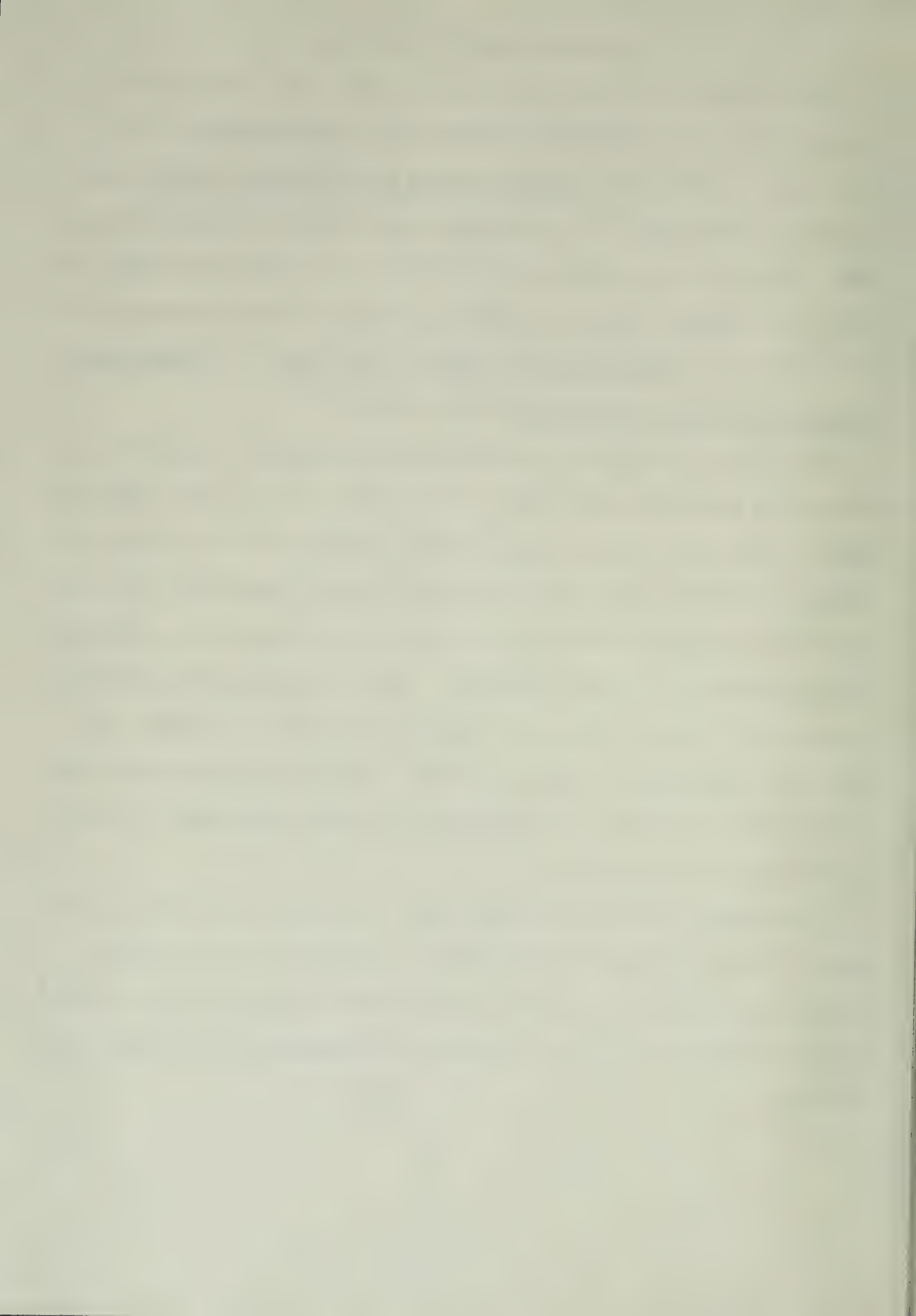


COUNTERSTATEMENT OF THE CASE

This litigation is before the Court a second time. The case has its roots in a rate investigation commenced by the Commission in its Docket Nos. 969 and 1067, Alaskan Seasonal Rate Increases (1962), which resulted in two orders of the Commission dated March 5, 1964, and May 12, 1964. In the previous litigation this Court reviewed the two orders, set them aside, enjoined their enforcement, and remanded the proceedings to the Commission. Alaska Steamship Company, Inc., et al. v. Federal Maritime Commission and United States, 344 F.2d 810.

The instant review suit was initiated to review the Commission's order entered pursuant to the remand of this Court. In an order dated August 19, 1965, the Commission made certain corrections in the income tax allowance of Alaska Steam, pursuant to this Court's direction, and at the same time it denied a renewed motion to reopen the Commission proceedings for the reception of further evidence. The petition to review followed on September 7, 1965. After oral argument, the Court on November 17, 1965, denied petitioners' application for interlocutory injunction, without prejudice, and passed the application to adduce additional evidence to the hearing on the merits.

The issues now before the Court are: (1) Whether the denial on August 19, 1965, of Alaska Steam's motion to reopen was such an abuse of discretion as to warrant reversal by this Court; and (2) Whether the Commission carried out the Court's mandate in recomputing Alaska Steam's income tax.



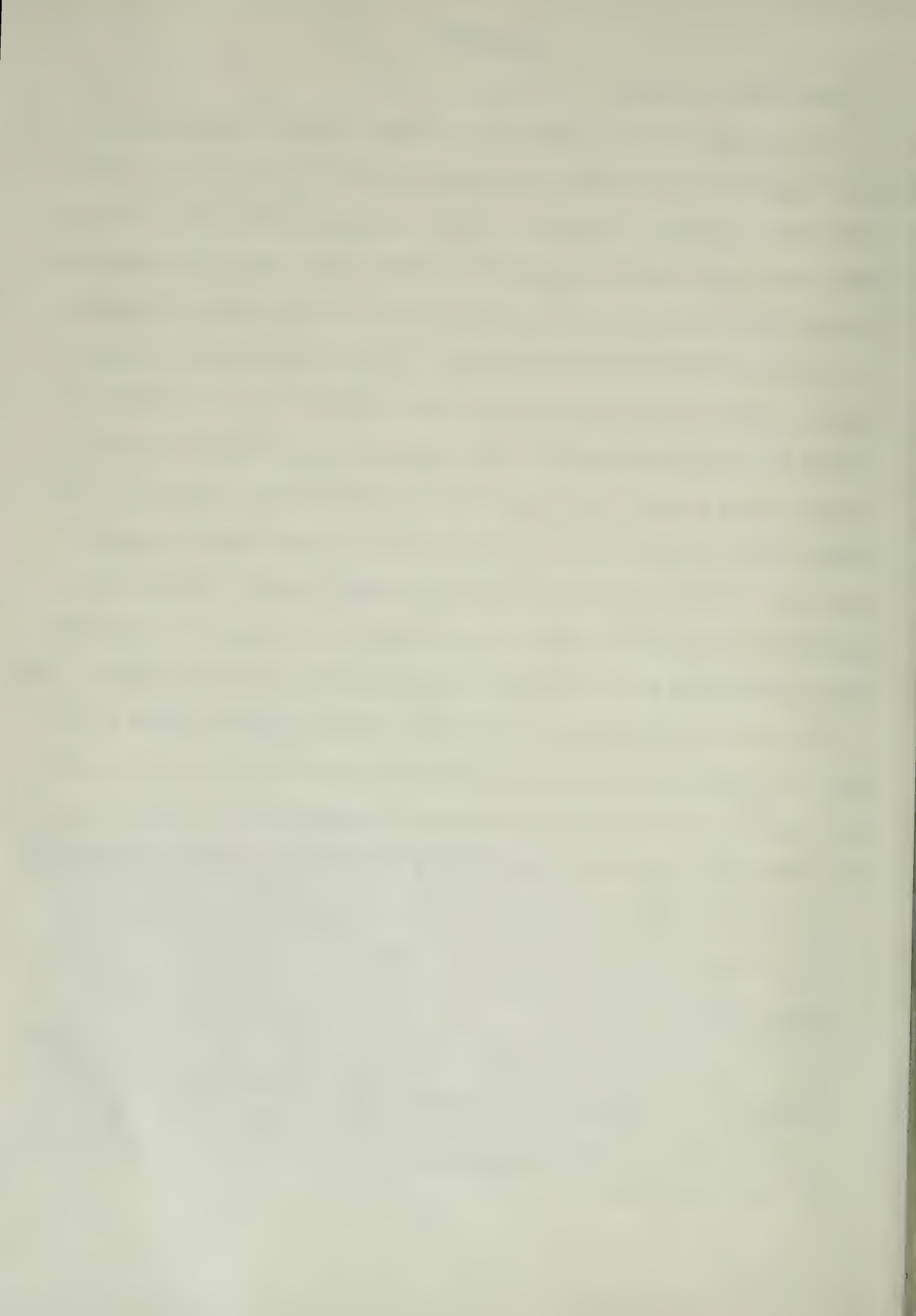
ARGUMENT

I. THE MOTION TO REOPEN

On the prior review proceeding, the Court found it unnecessary to decide whether it was an abuse of discretion for the Commission to deny petitioners' request to reopen to receive operating results for 1962 and 1963. The Court noted that another year had passed since the earlier motion had been made and that the proceeding must in any event be reopened on the remand ordered on other grounds. In the light of these circumstances, the Court felt that any objections based on the ground that reopening would further delay the termination of the proceeding were entitled to less weight. The Court therefore returned the case to the Commission with directions to give petitioners "the opportunity to again move for a reopening to receive later operating figures," although expressly observing that it would not necessarily be an abuse of discretion for the Commission not to reopen the investigation for this purpose (R. 209).

On remand, the Commission denied petitioners' renewed motion to reopen. In refusing to reopen, the Commission pointed out that only in the rare case are private litigants entitled to rehearings to bring the record

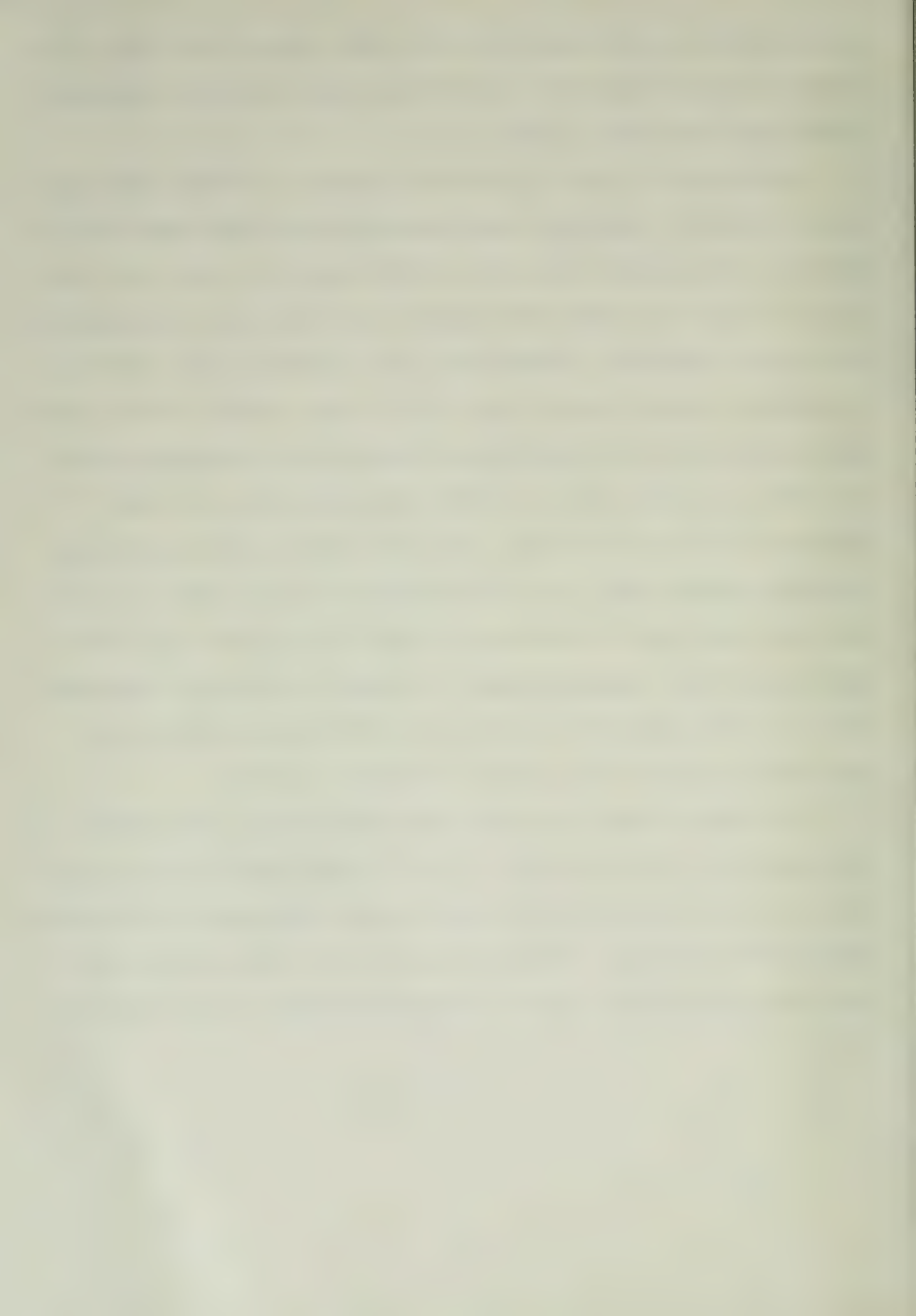
^{1/} The cases support the Commission's view that it has broad discretion in deciding whether or not to reopen to let in later operating results, and that its discretion should not be invoked to grant reopenings except for "unusual and weighty reasons" (R. 231). See cases cited in the Commission's Order, R. 229-230. The Court's attention is also invited to two additional cases not cited there. In Wilson and Co. v. United States, 335 F.2d 788, at 799 (7th Cir. 1964), the court of appeals held that there was no showing that the Federal Communications Commission abused its discretion in not reopening a Commission proceeding to receive further testimony. And, in Virginia Petroleum Jobbers Association v. Federal Power Commission, 293 F.2d 527, at 529 (D. C. Cir. 1961), the court of appeals held that the Federal Power Commission did not abuse its discretion by denying a reopening so that the petitioner could show rate changes which might have affected the feasibility of a pipeline project.



up to date and, in the Commission's view, this was not such a case. The Commission re-emphasized that the 1962 test year used in the Commission investigation was still a typical year.

Petitioners have not challenged this finding. Instead, they sought to put before the Commission later operating results which they claim to have been "disastrous." But, even if their claim were correct, the question would still be whether the test year was fairly representational of petitioners' operations. Operations in the seasonal service tend to run in four-year cycles; the first year of the cycle showing the most profitable results, and each succeeding year reflecting a progressive decline in profits, so that at the end of the fourth year the profits are smallest or there may be losses. Thus, the second or third years tend to be the average years. In the Commission's view, the 1962 test year was such a year and, in re-emphasizing that this year was still "representational," the Commission sought to respond to the Court's statement that "with the passage of each year, the 1962 test year becomes more and more vulnerable to the charge of staleness" (R. 209).

The Commission was also of the view that since the test year was representational a reopening to let in later figures--apart from the unlikelihood of affecting the results--would create a substantial delay in terminating the proceeding. Reopening would not be a perfunctory matter, the Commission believed, because receipt of further evidence would be in



an adversary proceeding with examination and cross-examination of witnesses, briefs, an Initial Decision, Exceptions, Replies to Exceptions, Oral Argument, and a final decision (R. 229). Furthermore, the Reply of the State of Alaska (R. 220) indicated that the State would contest the receipt of further evidence. The issue as to reopening was unlike the income tax question which was simultaneously remanded, because the latter issue required no more than a mathematical recomputation for its resolution.

The Commission also pointed out that allowance of petitioners' petition to reopen might result in a situation where pending rate cases could be indefinitely prolonged for the purpose of continually bringing the record up to date. As the Supreme Court observed in Interstate Commerce Commission v. City of Jersey City, 322 U.S. 503 (1944):

One of the grounds of resistance to administrative orders throughout federal experience with the administrative process has been the claims of private litigants to be entitled to rehearings to bring the record up to date and meanwhile to stall the enforcement of the administrative order. 322 U.S. at 514.

The instant case furnishes a dramatic example of repeated efforts at each stage of the proceedings to reopen the record for the purpose of letting

2/

in yet later operating results.

An additional consideration noted by the Commission in disallowing petitioners' motion to reopen was that petitioners could readily avail themselves of the conventional remedy of filing new tariffs showing rate increases, if they felt that operating results subsequent to the test year were typical and warranted the increases (R. 231). Petitioners contend (Br. p. 10) that they could not file increased rates because the May 12, 1964, Order of the Commission specified rate decreases, not increases. Petitioners, however, overlook the fact that they sought and obtained an injunction against the effectiveness of the Commission's orders under review, with the result that the May 12th order was being stayed during the pendency of the review proceedings, and thus petitioners could have filed new tariffs at any time. The fact that they were

2/ At the end of the hearings held before the trial examiner, petitioners moved to have the record held open until March of 1963 for the receipt of operating results for November and December, 1962. This motion was denied. At the oral argument held before the Commission in November of 1963, the request was expanded to include results for all of 1963, but the Commission declined to grant the motion. After the issuance of the Commission's Report and first order, petitioners again moved to reopen, expanding their request to the year 1964. In its second order of May, 1964, the Commission denied the Motion (R. 119). During the previous review proceeding, petitioners filed an application to adduce additional evidence, which sought to let in results for 1962-1964 and prospective results following the date of the reopened hearing, if and when it was held. The Court passed that application to the hearing on the merits, and it was later denied without prejudice. On remand, the motion to reopen was renewed and included 1965 as well as all previous years. In the order now under review, that motion was denied (R. 227). In the instant review proceeding, another application to adduce additional evidence was filed which further expanded petitioners' previous motions to include evidence "for the year 1965 to the date of taking of such evidence . . . together with evidence of anticipated operation thereafter, . . ." (Application, p. 2). This motion is now before the Court for consideration.



not prevented from filing new tariffs was repeatedly brought to petitioners' attention by respondents' counsel at the hearing on the first application to adduce additional evidence in August, 1964, and at the hearing on the merits in January, 1965.

Finally, contrary to petitioners' suggestion (Brief, p. 7), the issue is not whether the Commission's denial of the previous petition to reopen was an abuse of discretion. The issue is whether the August 19th denial of the renewed motion is an abuse of the Commission's discretion. On this issue the Commission is plainly not foreclosed from amplifying the reasons given in connection with its denial of the previous petition. For, contrary to petitioners' contention, this Court did not hold that the Commission was in error in denying the previous petition. The Court expressly declined to pass on the Commission's ruling in this respect,^{3/} and it held only that, in view of the circumstances present at the time of its decision, petitioners should be given an opportunity to renew their petition to reopen. The Court invited the Commission to re-examine its reasons for denying the previous petition in the light of the circumstances adverted to by the Court, and as noted above, the Commission has done this, and it has also advanced additional reasons for denying the renewed motion.

^{3/} Neither the petition for rehearing filed in the previous review proceeding by the Commission nor the application for stay of mandate were in any way related to the Court's ruling that petitioners should again be given an opportunity to move for a reopening. The Commission requested rehearing on the sole question of income tax accounting, and consideration was being given to a petition for certiorari on this ground. Obviously the Commission has never suggested that its discretion in disposing of motions to reopen is absolute or that the Court is not free to review such dispositions.

II. THE INCOME TAX COMPUTATION

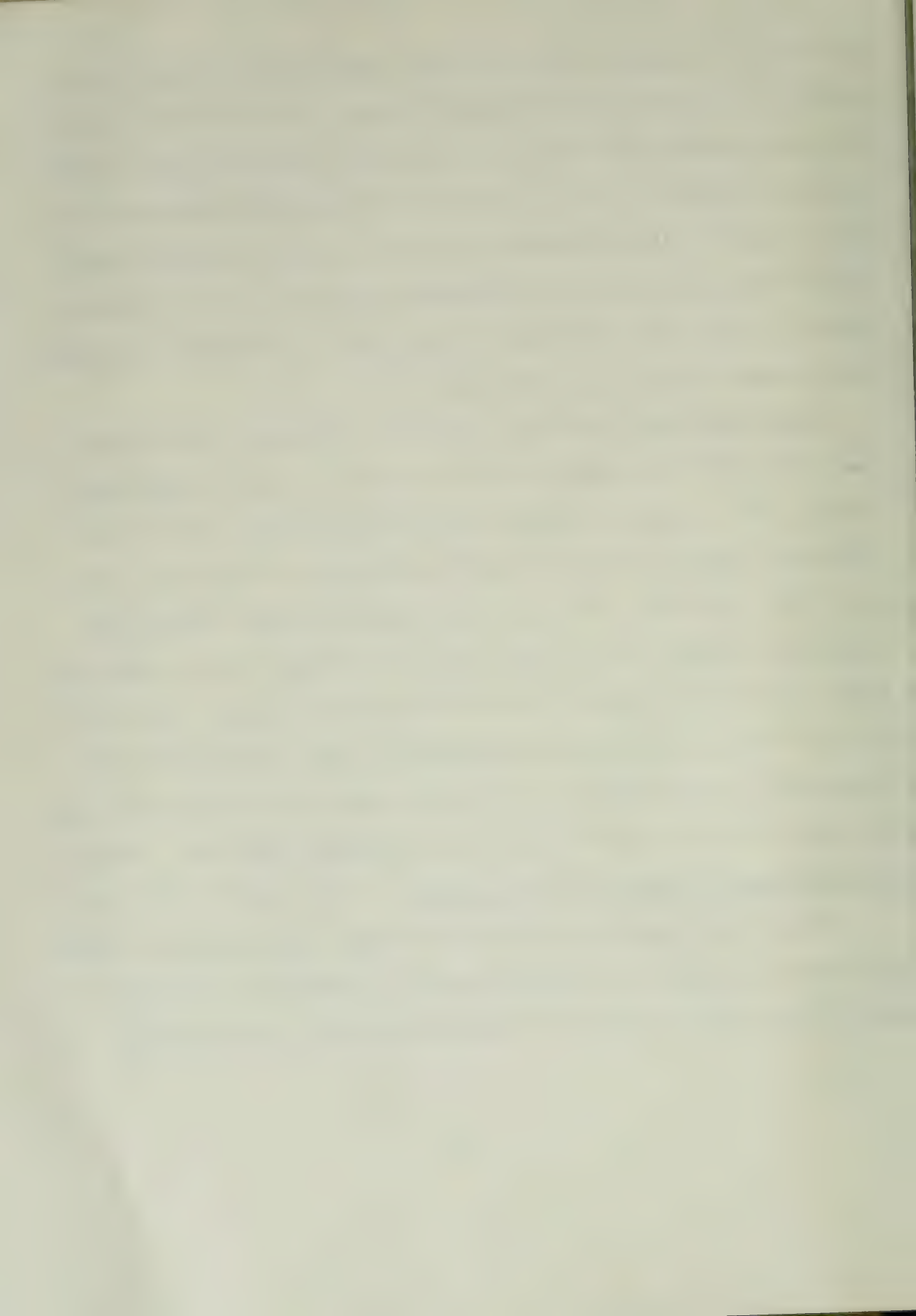
The primary reason for the remand to the Commission was to correct the income tax allocation for the seasonal service. The Court found that the Commission's action in using a 20-year life for income tax purposes while at the same time using a 25-year life for vessels for rate base purposes was arbitrary action necessitating a remand. Accordingly, the Commission undertook to recalculate the depreciation for income tax purposes, and the calculation is set out in the Commission's order (R. 232). The figures are shown in detail, and petitioners do not contend that the Commission has incorrectly computed the adjustment for depreciation. They do contend, however, that the Commission has made several other errors, none of which were contested in the previous review proceeding.

Respondents submit that petitioners should not now be permitted to raise issues which were not contested before the Commission or this Court during the first review proceeding. However, if the Court decides to examine these additional questions, it is respondents' position that they were all correctly decided by the Commission. Petitioners first contend that the Commission erred in its August 19th order in not correcting the allocation of administrative and general expense to the charter operation. The charter operation has no affect on the seasonal service except insofar as the profits or loss from it affect the income tax paid by Alaska Steam. The Commission has no jurisdiction over the charter operation, and thus

allocations of administrative and general expense made to it were not altered by the Commission in its original orders, and Alaska Steam did not raise any questions as to the charter operation during the course of the previous litigation. The total amount of administrative and general expense claimed by Alaska Steam was \$1,661,042, of which \$1,625,330 was allocated between the seasonal and scheduled services. As the allocations made by the Commission were upheld by this Court (R. 198-199), no changes were necessary in the August 19th order.

Petitioners also contest the Commission's deduction of an interest item of \$13,015 in the computation of income tax. That item represents interest paid on vessel mortgages during the test period, and it is included as a deduction in Alaska Steam's calculation of income tax. See Exh. 3-B-5. Obviously, if the carrier intended to deduct the item for income tax purposes, the Commission should also deduct it when calculating income taxes for the purpose of determining a rate of return. The fact that the item was disallowed as an expense for rate making purposes is irrelevant; the disallowance of the item for rate making purposes followed the Examiner's action (R. 56) and previous Commission practice. See General Increases in Alaskan Rates and Charges, 7 F.M.C. 563, at 575 (1963).

Finally, petitioners argue that the offshore charter operation should not have been treated as a separate service but should be considered as part of the seasonal service to determine the profit of the seasonal



service. This is a novel argument, advanced for the first time at this stage of the litigation. Suffice it to say that the Commission has no jurisdiction over the offshore charter operation, Alaska Steam itself treated the operation as a separate service, and the matter was not challenged in the previous review suit.

III. THE ISSUE OF CONFISCATION.

Petitioners contend that the August 19th order results in the confiscation of their property without due process of law. If the Commission did not abuse its discretion in refusing to reopen the record, and if petitioners have been given a fair rate of return, based on the figures of the test year, there is no confiscation. Petitioners' entire argument is premised on the case of Baltimore and Ohio Railroad Co. et al. v. United States, et al., 298 U.S. 349 (1936) which involved rate divisions ordered by the Interstate Commerce Commission. In that case, the railroad was powerless to alter the divisions and was required to serve the public at the rates prescribed. In the instant case, which is a far cry from the Baltimore and Ohio case, petitioners can file increased tariffs on thirty days' notice and thereby resolve their financial difficulties, if in fact any do exist.^{4/} This is not the case where petitioners are compelled to serve the public at the rates prescribed if in fact they feel the rates should be raised, and this is not the case where compliance

^{4/} See Respondents' Affidavit In Opposition To The Application For Interlocutory Injunction filed in this cause.



with the Commission's order results in a refunding procedure. The Inter-coastal Shipping Act, 1933, does not include a provision for refunding overcharges, and thus petitioners will be able to retain 100 percent of revenues heretofore collected.^{5/}

CONCLUSION

The order of the Commission should be affirmed.

Respectfully submitted,

Donald F. Turner
Assistant Attorney General

M. C. Miskovsky
Solicitor

Irwin A. Seibel
Attorney

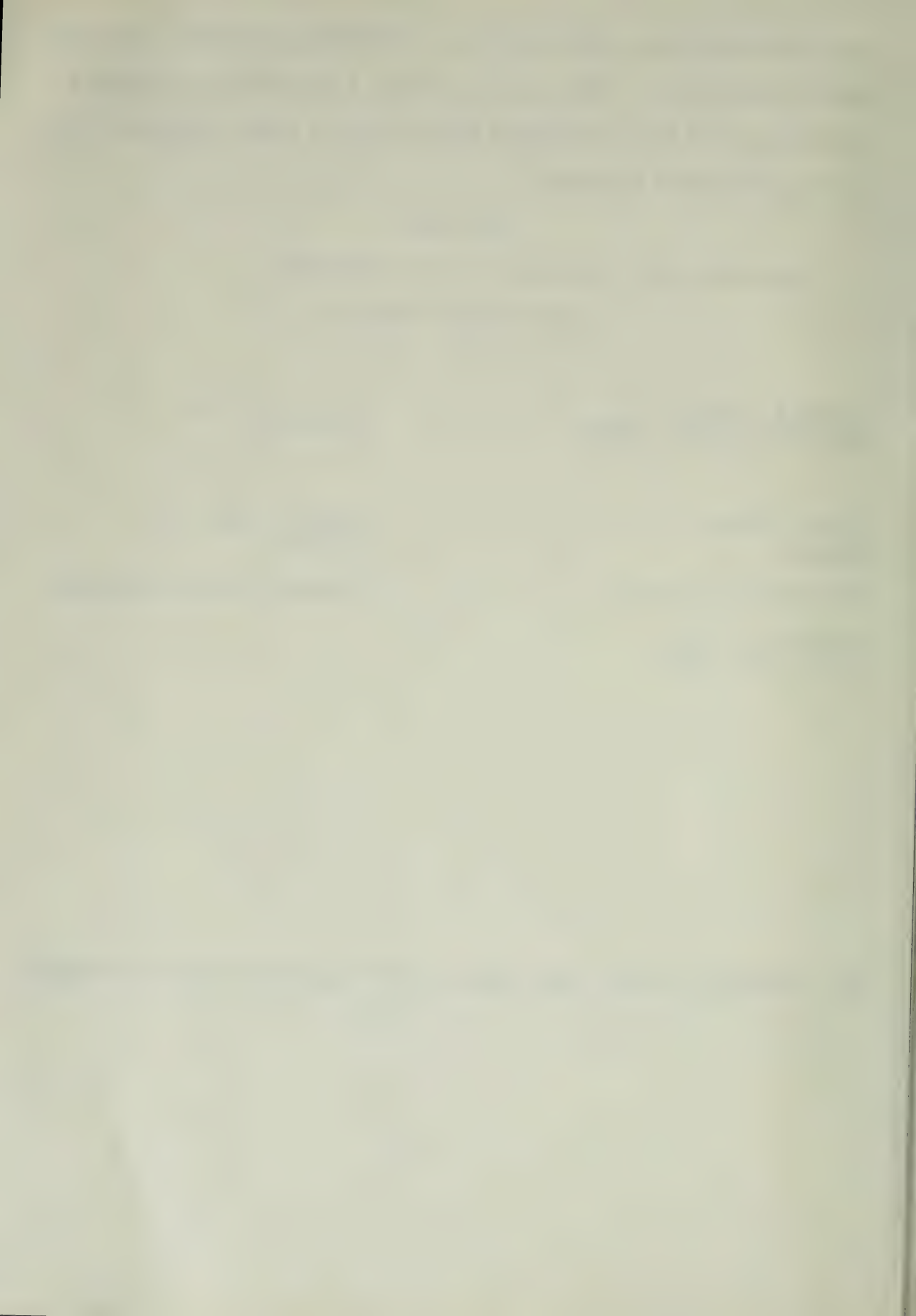
Walter H. Mayo III
Attorney

Department of Justice

Federal Maritime Commission

Washington, D. C.
December 15, 1965

^{5/} Absent, of course, any complaints for reparations filed by shippers.



CERTIFICATE OF COUNSEL AND OF SERVICE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

I further certify that I have this day served the foregoing document upon all parties of record in this proceeding by mailing via first class airmail, postage prepaid, three copies to each party or its attorney.

Dated at Washington, D. C., this 14th day of December 1965.

Walter H. Mayo III
Attorney
Federal Maritime Commission.

United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al.*, *Petitioners*,

vs.

FEDERAL MARITIME COMMISSION and UNITED STATES
OF AMERICA, *Respondents*.

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

REPLY BRIEF OF PETITIONERS

FILED

DEC 30 1965

FRANK H. SCHMIDT, CLERK

EDWARD G. DOBRIN

STANLEY B. LONG

ARTHUR G. GRUNKE

Attorneys for Petitioners

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG
Of Counsel

Office and Post Office Address:

14th Floor Norton Building
Seattle, Washington 98104

United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al.*, *Petitioners*,

VS.

FEDERAL MARITIME COMMISSION and UNITED STATES
OF AMERICA, *Respondents*.

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

REPLY BRIEF OF PETITIONERS

EDWARD G. DOBRIN

STANLEY B. LONG

ARTHUR G. GRUNKE

Attorneys for Petitioners

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG

Of Counsel

Office and Post Office Address:

14th Floor Norton Building

Seattle, Washington 98104



INDEX

	<i>Page</i>
Statement.....	1
Argument.....	1
I. The Renewed Motion to Reopen.....	1
II. The Income Tax Calculation.....	4
A. Error in Allocation of Administrative and General Expense.....	4
B. Error in Deduction of Interest in Deter- mining Federal Income Tax.....	5
III. The Issue of Confiscation.....	6
Conclusion.....	7

TABLE OF CASES

<i>American Trucking Assos. v. United States</i> , 344 U.S. 298 (1953).....	6
<i>Baltimore & O. R. Co. v. United States</i> , 298 U.S. 349 (1936).....	6
<i>New York v. United States</i> , 331 U.S. 284 (1947)	6

STATUTES

Title 46 U.S.C.A. § 845.....	6
------------------------------	---



United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, *et al*,
Petitioners,

vs.

FEDERAL MARITIME COMMISSION and
UNITED STATES OF AMERICA,
Respondents.

} No. 20351

PETITION FOR REVIEW OF ORDER OF FEDERAL MARITIME
COMMISSION

REPLY BRIEF OF PETITIONERS

STATEMENT

This is a reply to the Brief of Respondents.

ARGUMENT

I. The Renewed Motion to Reopen

Respondents do not attempt to justify the failure of the Commission to grant Alaska Steam a hearing on the renewed motion to reopen.

Alaska Steam asserts that the denial by the Commission of the renewed motion to reopen, thereby failing to comply with this Court's decision and decree in the prior review proceedings, is arbitrary and capricious and an abuse of discretion. This Court's decision and decree in the prior review proceedings are final and conclusive and no longer subject to reargument by way of amplification or otherwise.

This Court in its decision discussed the various considerations then urged by the Commission in support of its denial of Alaska Steam's motion to reopen and stated that it "need not decide whether there was an abuse of discretion in denying the motion to reopen" because Alaska Steam "should be permitted to renew that motion in the light of circumstances as they now exist." (R. 208.) This Court further stated that it was not thereby indicating "that it would necessarily be an abuse of discretion for the Commission not to reopen the investigation" inasmuch as there "*may be considerations not drawn to our attention which would warrant such a denial.*" (Emphasis supplied.) (R. 209.)

Alaska Steam filed a renewed motion to reopen and both Alaska Steam and the Commission's Hearing Counsel understood this Court to mean that if there were no such considerations, the Commission was to grant the renewed motion to reopen. The Commission apparently likewise so construed this Court's decision. The Commission referred to the above quoted language of this Court and stated in support of its denial of the renewed motion to reopen "that an amplification of the reasons advanced to the Court of Appeals in support of the argument that denial of Alaska Steam's previous petition to reopen was not an abuse of discretion *coupled with considerations not drawn to the Court's attention warrant the denial.*" (Emphasis supplied.) (R. 209.) The Commission's Hearing Counsel was of a contrary view. (Br. of Pet. p. 6.)

Petitioners in their opening brief have documented that all of the reasons and considerations asserted by

the Commission in its August 19, 1965 Order in support of its denial of the renewed motion to reopen were in fact considerations which had been drawn to this Court's attention in the prior review proceedings. The respondents make no contention to the contrary.

In the March 5, 1964 Order considered in the prior review proceedings the Commission affirmed the Examiner's finding that the 1962 test year was "a representational year" (R. 111). The Commission further found that the "record does not contain adequate information on seasonal operations over a 3-4 year period" to support the use of a 3-4 year red salmon run cycle as the test period (R. 111). Despite this, respondents make an argument based on alleged "four-year cycles" in the seasonal service which has no basis in any finding made by the Commission. Without findings of the Commission in support thereof, the respondents, in the prior review proceedings, stated that the 1962 test year "approximated the results of what would be an average year in the corporate life of Alaska Steam." (R. 229.) In the August 19, 1965 Order the Commission states that "We adhere to that statement made to the Court of Appeals." (R. 229.) Respondents assert that the Commission thereby sought to respond to this Court's statement that "with the passage of each year, the 1962 test year becomes more and more vulnerable to the charge of staleness." (Br. for Resp. p. 3.) The significance of this argument by respondents is not apparent, but it is apparent that nothing new has been added to the reasons and considerations urged upon this Court in the prior review proceedings.

II. The Income Tax Calculation

Respondents are in error in asserting that the correction of the income tax allocation was the primary reason for this Court remanding the proceedings to the Commission. It was, however, an important reason and has alone resulted in a correction of major importance, namely, a corrected finding that the rate of return in the seasonal service at the Company rates based on the test period was 13.97% rather than 19.75%.

A. Error in Allocation of Administrative and General Expense

In the prior review proceedings Alaska Steam sought approval for the allocation of administrative and general expense on the basis of actual vessel days in accordance with a General Order of the Maritime Administration rather than on the formula adopted by the Commission, namely, the proportion that the total vessel operating expense of each service bears to the total vessel operating expense. This Court approved the Commission's choice of formula stating that it "does not represent arbitrary action." (R. 199.)

The Commission's formula having been thus approved should have been used by the Commission in its August 19, 1965 Order in allocating administrative and general expense for the purpose of determining the gross and net income of the seasonal service. The Commission, however, did not do so but on the contrary used the rejected Alaska Steam's formula for the purpose of allocating this expense to the charter operation of the vessel TALKEETNA and then proceeded to use the Commission's formula approved by this Court in allocating

the remainder of this expense between the seasonal and scheduled services. Contrary to respondents' contention this error affects both the determination of gross profit and the determination of income tax liability for the purpose of arriving at net profit in the seasonal service. It erroneously increases the loss incurred in the charter operation by \$21,361 and erroneously increases the gross profit of the seasonal service by \$5,054. (Br. of Pet., App. Sch. 1.) This further results in an erroneous determination of the rate of return in the seasonal service at the Company rates based on the test period. (Br. of Pet., App. Sch. 2.)

Respondents further assert that the Commission has no jurisdiction over the charter operation. This, of course, has no bearing on the Commission's obligation to make a proper allocation of the administrative and general expense. If, as the Commission states, it has no jurisdiction over the charter operation, the results of that operation should not be included in making the income tax calculation. If not included the rate of return in the seasonal service at the company rates based on the test period would be something less than 12.85%.¹

B. Error in Deduction of Interest in Determining Federal Income Tax

In Exhibit 3-B-5, sheet 2, Alaska Steam deducted an interest item of \$13,015 in determining the gross profit of the over-all Alaska operation. It was only for this reason that this item entered into Alaska Steam's determination of federal income tax in this exhibit. The

¹Application of the calculation in Brief of Petitioners, App. Sch. 2, Col. B, omitting "Other" and increasing "Total" to \$412,519.

Commission can scarcely properly rely upon this as a basis for asserting that Alaska Steam, having deducted the item for income tax purposes, the Commission should also do so.

III. The Issue of Confiscation

The constitutional principle announced in *Baltimore & O. R. Co. v. United States*, 298 U.S. 349 (1936) applies equally to both divisions and rates prescribed by a regulatory agency. This is clearly recognized in the earlier cases cited in that decision and in the later cases of *New York v. United States*, 331 U.S. 284 (1947) and *American Trucking Assos. v. United States*, 344 U.S. 298 (1953) on which petitioners rely. It is no defense to the claim of constitutional confiscation here asserted to state that Alaska Steam may file increased tariffs on thirty days notice following compliance with the Commission's order requiring the filing of decreased rates. If Alaska Steam after filing decreased rates, files increased rates such rates will be subject to suspension under its statutory authority to do so. (Br. of Pet., pp. 11, 12, Title 46 U.S.C.A. §845.) Within the four-month statutory period of suspension the Commission may, after hearing, permanently suspend the increased rates, leaving Alaska Steam to its remedy by review. Until eventual relief is obtained by review proceedings the confiscatory decreased rates will remain in effect.

The fact of confiscation, not the period during which it will continue to exist, would appear to be the circumstance entitling Alaska Steam to seek judicial protection. It is believed that Alaska Steam has established

its right to have the issue of confiscation determined by this Court.

CONCLUSION

The prayer of the petition for review should be granted.

Respectfully submitted,

EDWARD G. DOBRIN

STANLEY B. LONG

ARTHUR G. GRUNKE

Attorneys for Petitioners

BOGLE, GATES, DOBRIN, WAKEFIELD & LONG
Of Counsel

Office and Post Office Address:
14th Floor Norton Building
Seattle, Washington 98104

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ARTHUR G. GRUNKE
Attorney



No. 20415 ✓

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, Trustee of the Estate of Pomona Properties, Inc., doing business as STEVE'S RANCH MARKET, Bankrupt,

Appellee.

Appeal From the United States District Court for the
Southern District of California Central Division.

APPELLANT'S OPENING BRIEF.

JAMES J. ARDITTO,

611 Sunset Boulevard,
Los Angeles, Calif. 90012,

Attorney for Appellant.

FILED

NOV 30 1965

FRANK H. SCHMID, CLERK

TOPICAL INDEX

	Page
A. Statement as to jurisdiction	1
B. Statement of facts	3
I.	
Background	3
II.	
General facts	9
(a) The collection of rents by Appellant	9
(b) The \$20,000.00 exchange of checks	12
(c) The \$28,000.00 withdrawn—by Appel- lant—on February 20, 1961	18
C. Statement of the case	20
D. Assignment of Errors	22
E. Argument	22
I.	
Appellant was entitled to an “off-set” of \$5,599.95 against the \$5,400.00 of rents collected by ap- lant	22
II.	
Appellant did not commit any constructive fraud —against general creditors of the bankruptcy— by cashing the two (2) \$10,000.00 exchange checks	24
III.	
Appellant should not be required to return—for a second time—the \$28,000.00 he withdrew on February 20, 1961	36

ii.

IV.

Page

In any event, Appellant is entitled to file a claim —as a general creditor—if he is required to re- turn the \$20,000.00 and \$28,000.00	38
Conclusion	39
Appendix. List of Exhibits as required by Rule 18(f)	App. p. 1

TABLE OF AUTHORITIES CITED

Cases	Page
Bonney v. Tilley, 109 Cal. 346	24, 27, 28, 35
Field, In re, Heating & Ventilating Co., 201 F. 2d 316	24
Hickson v. Thielman, 147 Cal. App. 2d 11, 304 P. 2d 122	37
Rudd, In re, 180 Fed. 312	24
T.I.T. Co. v. Calif. Develop. Co., 171 Cal. 173	24, 27, 28, 35

Statutes

Bankruptcy Act, Sec. 1(19)	31
Bankruptcy Act, Sec. 11(e)	7, 12, 13, 19, 25, 36
Bankruptcy Act, Sec. 24	1, 3
Bankruptcy Act, Sec. 25	3
Bankruptcy Act, Sec. 60	7, 8, 12, 13, 19, 25, 36
Bankruptcy Act, Sec. 67(d)	25, 36
Bankruptcy Act, Sec. 67(d)(1)(d)	31
Bankruptcy Act, Sec. 68	23
Bankruptcy Act, Sec. 68(a)	37
Bankruptcy Act, Sec. 70	25
Civil Code, Sec. 3439	8, 20, 25, 31
Civil Code, Sec. 3439.02(a)	31
Civil Code, Sec. 3439.07	37
United States Code Annotated, Title 11, Sec. 47	1
United States Code Annotated, Title 11, Secs. 47-48	3

iv.

Textbooks

9 American Jurisprudence 2d, p. 396	23
9 American Jurisprudence 2d, Sec. 454, p. 353	39
9 American Jurisprudence 2d, Sec. 511, p. 396	23
9 American Jurisprudence 2d, Sec. 512, p. 397	24
9 American Jurisprudence 2d, Sec. 1055, p. 783	29
9 American Jurisprudence 2d, Sec. 1055, pp. 783-784	31
9 American Jurisprudence 2d, Sec. 1065	31
9 American Jurisprudence 2d, Sec. 1066	31
9 American Jurisprudence 2d, Sec. 1113	31
9 American Jurisprudence 2d, Secs. 1185-1187, pp. 880-882	31
9 American Jurisprudence 2d, Sec. 1189, pp. 883-884	34
23 California Jurisprudence 2d, Secs. 94-100, pp. 540-545	37
23 California Jurisprudence 2d, p. 545, n. 14 (1964 Supp.)	37
44 California Jurisprudence 2d, p. 634	24
Collier, Bankruptcy Manual, Sec. 68.04	23
Collier, Bankruptcy Manual, Sec. 68.08	23
Collier, Bankruptcy Manual, Sec. 68.12	23
Collier, Bankruptcy Manual, p. 904	24
Cowan, Bankruptcy Law and Practice, Sec. 25, p. 25	31
Cowan, Bankruptcy Law and Practice, Sec. 751, pp. 397-398	30

No. 20415
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, Trustee of the Estate of Pomona Properties, Inc., doing business as STEVE'S RANCH MARKET, Bankrupt,

Appellee.

Appeal From the United States District Court for the
Southern District of California Central Division.

APPELLANT'S OPENING BRIEF.

A. STATEMENT AS TO JURISDICTION.

The United States District Court, Southern District of California, Central Division, is a Court of Bankruptcy within the jurisdiction of the United States Court of Appeals for the Ninth (9th) Circuit. [Sec. 24 of Bankruptcy Act—11 U.S.C.A. §47.]

On April 19, 1963, Appellee filed with the said United States District Court an "Application for Order Requiring Return of Converted Assets and to Set Aside Preferences and Fraudulent Conveyances." [Tr. pp. 34-41.]

Appellant filed his answer to said application on May 13, 1963. [Tr. pp. 42-45.]

On September 11, 1963 (after a hearing was had—before Hon. Russell Seymour, Referee in Bankruptcy (to whom this matter was referred)—on June 17 and 24, 1963 [See Transcript of June 17, 1963, hearing attached to Referee's Certificate on Application for Review of Order of December 11, 1964 [Tr. p. 115]]), Appellee filed an amended Application. [Tr. pp. 57-62.]

Appellant filed an answer to this amended application. [Tr. pp. 63-67.]

Further hearings were held before the said Referee on November 13, December 11 and December 18, 1963, and on January 13, 1964. [Tr. p. 114, lines 3-5.]

On July 27, 1964, said Referee filed a Memorandum Opinion. [Tr. pp. 72-75.]

On December 11, 1964, said Referee signed and filed Findings of Fact and Conclusions of Law. [Tr. pp. 76-90.]

Appellant had objected to said Findings and Conclusions. [Tr. pp. 91-98.]

On December 11, 1964, said Referee signed and filed "Order Requiring Return of Converted Assets, etc." [Tr. pp. 99-101.]

On December 21, 1964, Appellant filed his Petition for Review (of said Order of December 11, 1964) with the said District Court. [Tr. pp. 102-110.]

On June 29, 1965, a hearing was held before Hon. William M. Byrne—Judge Presiding in said District Court. [Tr. Vol. II.]

On July 12, 1965, the said Hon. William M. Byrne filed his Order on said Petition for Review. [Tr. pp. 124-126.]

Appellant filed his Notice of Appeal to the above-entitled Court on July 16, 1965. [Tr. p. 127.]

Appellant filed his Statement of Points and Designation of Record. [Tr. pp. 128-134 (last 7 pages of Tr.).]

This Court has jurisdiction to entertain this appeal by virtue of the provisions of Sections 24 and 25 of the Bankruptcy Act [11 U.S.C.A. Secs. 47-48].

B. STATEMENT OF FACTS.

I.

Background.

About January 20, 1961, Pomona Properties, Inc. (called "Bankrupt") acquired a retail food store and business from McDaniel Markets (located in Inglewood, California). [Trustee's Ex. A.] Bankrupt commenced its business on January 30, 1961, and on February 24, 1961—about 25 days later—the Sheriff's office took possession and control of the premises and business (pursuant to a creditor's attachment). On March 1, 1961 (about 30 days after Bankrupt commenced business), an Involuntary Petition in Bankruptcy was filed against Bankrupt and Appellee took over (from the Sheriff) as Receiver (Appellee became Trustee upon adjudication on April 5, 1961). [Rep. Tr.* pp. 99, 108, 115-116 and Tr. pp. 2-5.]

Appellant filed claims against Bankrupt—for \$42,000.00 and \$60,000.00 (Both evidenced by promissory notes executed by Bankrupt—see Tr. p. 29, line 13, to p. 30, line 12]. [Creditor's Ex. 21 and Tr. p. 27, lines 13-29.] The Appellant objected to said claims and, after hearings, the Referee—treating said sums as "contribu-

*References are to Transcript of Proceedings before Hon. Russell B. Seymour, Referee.

tions to capital”—allowed said claims as “subordinated claims”. [Exs. M and N and Tr. pp. 26-33.]

No appeal was taken from the Referee’s Findings and Order of July 26, 1962 [Tr. p. 30, lines 14-26 and pp. 32-34] and thus the parties hereto are—Appellant respectfully submits—bound (*res adjudicata* or collateral estoppel—Rep. Tr. p. 5, lines 13-18] by the Court’s Findings of July 26, 1962 [Paragraphs XII and XIII of said Findings], that:

- (1) Appellant made “contributions of capital” to Bankrupt of said \$42,000.00 and \$60,000.00; and
- (2) Appellant did *not* “sell or loan” (and thus Bankrupt did *not* incur an “indebtedness” therefor) anything to Bankrupt—represented by this \$42,000.00 and \$60,000.00 [Tr. p. 30, lines 14-26.]

On January 11, 1961 (about 20 days *before* Bankrupt commenced business), Appellant had caused six (6) notes and second deeds of trust (totaling \$42,000.00) to be transferred to Bankrupt—which used the same to partially pay for about \$55,000.00 (wholesale) of groceries, etc. (*i.e.*, inventory) sold to Bankrupt by McDaniels Market [Tr. p. 29, lines 13-19, and lines 31-32, and p. 30, lines 1-12].

Bankrupt—and its creditors—thus received a \$42,000.00 benefit from Appellant. (As a matter of fact, under the—at least—25% “mark-up” [see Ex. S, pp. 2-3], the creditors benefited by about \$52,000.00) *This sum was never repaid to Appellant because* the Referee “found” that Appellant had made a “contribution of capital” of this amount to Bankrupt.

On About February 2, 1961 (three (3) days after Bankrupt commenced business), Bankrupt gave Appellant a \$60,000.00 promissory note [*to be paid when Bankrupt could*—with no down payment—see Exhibit M, p. 98, lines 1-10, and Rep. Tr. p. 213, lines 15-23] in exchange for a grant deed Appellant executed to Bankrupt (covering six (6) apartment buildings (of six (6) units each) located in Santa Ana, California) [Creditor's Ex. 4, and Tr. p. 29, lines 21-29, and p. 30, lines 14-19 and lines 28-32.]

(These Santa Ana apartment buildings were acquired—from Appellant—by Bankrupt—“subject to” (1) first deeds of trust for \$25,000.00 (each apartment building) and (2) second deeds of trust for \$7,000.00 (each apartment building)—the latter deeds of trust were acquired by McDaniels Market (from Bankrupt—who acquired the same from Appellant) as payment of \$42,000.00 (6 X \$7,000) of \$55,000.00 of *wholesale* inventory (as aforesaid).)

On March 6, 1961, the Appellee reported Bankrupt still had about \$80,000.00 of inventory (at retail—but about \$57,500.00 at wholesale). [Ex. S, pp. 10-11.]

Appellant also notes that the “sheriff” had sold about \$9,000.00 of inventory between February 24 and 26, 1961 [Ex. S, p. 8] and that Appellee had sold about \$11,300.00 (and purchased about \$4,500.00) of inventory between March 1-5, 1961. [Ex. S, p. 11 (middle of page).]

The Appellant also notes that the Appellee sold all remaining inventory, beer and wine license and sublease—about July 12, 1961—for about \$27,500.00. [Tr. pp. 9-25.]

(It is also noted that except for the refusal of Eleanor Tavluian (*whom appellant understands to be Mrs. Dadian*) [Ex. M, p. 23, lines 12-18; p. 24, line 25; p. 25, lines 1-3; p. 127, lines 13-24]) to consent to the transfer of the lease—the Bankrupt would have realized return of six second deeds of trust (from McDaniels Market) plus \$30,000.00 plus wholesale value of inventory minus \$35,000.00 to be paid to McDaniels Market—Tr. pp. 9-22.)

Having disposed of Appellant's claims—by obtaining a Finding that they were “contributions to capital”—(and thus putting the creditors in a position where “they” had obtained the benefit of at least \$42,000.00 (\$52,000.00 in sales) of “free inventory”) the Appellee then proceeded—*on April 19, 1963*—to seek a court order requiring Appellant to:

- (a) Return \$4,000 to \$4,500 of rents—which Appellant admitted he collected from the Santa Ana apartments between March 2 and June, 1961 (at a time when Appellee was taking the position that he didn't know whether he was going to “recognize” the February, 1961, “sale” of the Santa Ana apartments by Appellant to Bankrupt—with Appellee finally *on November 2, 1961*, deciding that he could “recognize” the “sale”, but *not* “recognize” the \$60,000.00 “sale note”—See Ex. N, p. 11, lines 11-15; p. 13, lines 5-17; Ex. K];

- (b) Return \$20,000.00 which Appellant had obtained from Bankrupt—as a repayment of a \$20,000.00 loan which Appellant had caused to be made to Bankrupt [Tr. p. 86, lines 18-30];
- (c) Pay—for a second time—\$28,000.00 which Appellant had withdrawn from Bankrupt's bank account on February 20, 1961—but returned to Bankrupt (*and its creditors*) and as follows:
 - (1) \$14,000.00—on February 21, 1961;
 - (2) \$8,000.00—on February 23, 1961;
 - (3) \$8,000.00—on March 1, 1961.

[Tr. p. 74, lines 8-9, and p. 88, lines 19-21.]

The original theory of Appellee was that Appellant had to return the rents (collected *after* Petition in Bankruptcy filed—with knowledge of the bankruptcy proceedings) and the Appellee could recover the \$20,000.00 and the \$28,000.00 on the theory that Appellant had created “preferences”—*under Section 60 of the Bankruptcy Act*—which he could be made to return [see original Application for Order to Show Cause filed April 19, 1963—Tr. pp. 34-39].

At the June 17 and 24, 1963, hearings, *the Referee ruled that any action*—to set aside alleged preferences under Section 60 of the Bankruptcy Act—was barred by the two (2) year statute of limitations prescribed by Section 11(e) of the Bankruptcy Act. [Rep. Tr. pp. 24-33.]

In other words, the Court ruled that the fact that \$20,000.00 and \$28,000.00 was, in effect, paid to general creditors *before* bankruptcy (and thus a “preference” *might* have been given to *those* creditors over “creditors of the Bankrupt Estate”) was immaterial

because the two (2) year statute of limitations (April 5, 1961—April 5, 1963) barred any action on the theory of “Section 60 preferences”.

Then Appellee—on September 11, 1963—filed an *amended* application [Tr. pp. 48-62] and attempted to recover the \$20,000.00 and \$28,000.00 on the theory that:

- (a) *Second Cause of Action* [Tr. pp. 59-60]. “Director’s Preference” at time of insolvency within the purview of California cases (given to Appellee by Referee). [Rep. Tr. p. 33, lines 17-26, to p. 34, line 1.]
- (b) *Third Cause of Action* [Tr. pp. 60-61]. Fraudulent transfer within California Uniform Fraudulent Conveyance Act. (Civil Code—§§3439 *et. seq.*).

The case then proceeded to trial—Rep. Tr. pp. 31 to end—(as to \$20,000.00 and \$28,000.00) with Appellee trying to prove:

- (1) *Second Cause of Action*. Appellant (referee having “found” him to be person “in control” of Bankrupt [Tr. p. 28])—although Appellant was never a stockholder, officer or Director of Bankrupt [Ex. M, p. 41, lines 15-26, 54 and pp. 63-70, 75, pp. 80-82 and pp. 120-128]—in bad faith—to give himself a preference over other creditors—caused Bankrupt to pay him \$20,000.00 at a time when Bankrupt was “insolvent” and Appellant knew this;
- (2) *Third Cause of Action*. Appellant fraudulently (*i.e.*, to hinder, etc., creditors) transferred \$28,000.00 to himself on February 20, 1961.

II.

General Facts.

(a) *The Collection of Rents by Appellant.*

On March 1, 1961, an Involuntary Petition in Bankruptcy was filed against Bankrupt. [Tr. pp. 2-5.] Appellee was appointed Receiver. [Tr. p. 9, lines 21-24.] On April 5, 1961, there was an adjudication of bankruptcy and on April 21, 1961, Appellee was appointed Trustee. [Tr. p. 77, lines 15-23.]

Between May 10, 1961, and June 15, 1961, Appellant collected \$5,400.00 of rents from tenants of the Santa Ana apartments (which had been transferred to Bankrupt on February 7, 1961—see Creditor's Ex. No. 4 [Tr. p. 85, lines 20-27].)

Demand was made—by Appellee—upon Appellant to return these rents on November 2, 1961 (between April 5 and November 1, 1961, Appellee would not give Appellant any final answer as to whether Appellee was going to recognize the February 7, 1961, transfer). [Ex. N, p. 11, lines 11-15 and p. 13, lines 5-17.]

Appellant admits collecting these rents, but contends that he is entitled to an “off-set” for the following amounts paid to—or for the benefit of—the Bankrupt or its creditors:

- (1) \$2,000.00 (of \$8,000.00) paid on March 1, 1961 [Ex. N, pp. 19-21 and Rep. Tr. pp. 230-242];
- (2) \$2,199.95 paid between March 1 and 16, 1961 [Ex. N, pp. 21-22];
- (3) \$1,400.00 paid between May 16 and 25, 1961 (used to pay utility bills) (which the United States District Court *held* were used to pay

customers' utility bills, but Referee having given Appellant credit for only \$900.00 [Tr. Vol. II, pp. 8-12, and p. 14, lines 9-11.])

These rents were collected *after* Petition in Bankruptcy was filed and the amounts paid by Appellant (and claimed as an offset) were paid *after* said Petition was filed.

There is no conflict whatsoever as to the facts that (1) Appellant collected the \$5,400.00 of rents and (2) Appellant actually repaid \$5,599.95 and (3) that such collections and repayments occurred *after* Petition in Bankruptcy (and at the time Appellee was Receiver or Trustee—Tr. p. 77, lines 20-23] was filed herein. [Ex. N, pp. 18-24, Creditors' Exs. 9 and 12, Exs. I and J and Ex. M, pp. 136-162.]

The Referee found [Tr. p. 85, line 28] that the \$900.00 of rent collected on May 16, 1961, was used to pay customers' utility bills and allowed this "as an offset"—but refused to allow the \$400.00 and \$100.00 [May 17 and 25, 1961—Tr. p. 85, lines 25-26] of rent collected to be offset. [Tr. p. 85, lines 28-31.] However, the United States District Court reversed the Referee on this point and allowed said \$400.00 and \$100.00 to be used as "off-sets". [Tr. Vol. II, p. 9, lines 16-25; p. 14, lines 9-11 and Tr. p. 125.]

The Referee found that \$8,000.00 (of the \$28,000.00 taken on February 20, 1961) was paid back by Appellant on March 1, 1961—the day the bankruptcy petition was filed herein and Appellee was appointed Receiver. [Tr. p. 88, line 21, and p. 77, lines 15-23.] Appellant had already (February 21 and February 23, 1961) returned \$22,000.00 [Tr. p. 88, lines 19-20] of the

\$28,000.00 taken on February 20, 1961, and therefore Appellant claims the extra \$2,000.00 (\$22,000 + \$6,000 = \$28,000 and Appellant, in paying \$8,000.00 on March 1, 1961, had overpaid the \$28,000.00 by \$2,000.00) as an off-set against the \$5,400.00 of rent collected (by Appellant).

The Referee further found that there was no credible evidence of any further (over \$30,000.00) payment by Appellant. [Tr. p. 88, lines 21-23.] This Finding is directly contrary (the said District Court disagreed—with the Referee—as to \$500) to the only evidence introduced in this record—which clearly established that:

- (1) Appellant paid back \$1,400.00—which was used to pay utility bills [Ex. N, pp. 18-24] ;
- (2) Appellant paid back \$2,199.95—which was also used to pay utility bills. [Ex. N, pp. 18-21, Creditors' Exs. 9 and 12, Ex. M, pp. 136-162 and Exs. I and J.]

[Bankrupt rendered a “utility bill paying service” for its customers—*i.e.*, customers would give Bankrupt money to pay their utility bills and Bankrupt—in turn—would pay the utility company. These customers would clearly be “creditors of the Bankruptcy Estate—if these bills had *not* been paid—Ex. N, pp. 18-24, Ex. M, pp. 136-162.]

The Referee also “found”, in effect, that—in any event—these funds (\$14,000, \$8,000 and \$8,000—\$2,000 of which we are concerned with at this point) were paid back “before Petition filed” and “creditors of the estate never benefited from such repayment. [Tr. p. 89, lines 3-12.]

The facts are that:

- (1) \$2,000.00 (of the \$8,000) was paid back—and used for “general creditors”—on the day that bankruptcy proceedings were initiated—*i.e.*, March 1, 1961 [Ex. N, p. 21; Rep. Tr. pp. 237-243];
- (2) \$2,199.95 was repaid—and used for “general creditors”—between March 1 and 16, 1961. [Ex. N. pp. 18-24 and Ex. M, pp. 136-142.]
- (3) \$1,400.00 was repaid—and used for “general creditors”—between May 16 and 25, 1961. [Ex. N, pp. 18-24.]

(This finding—Tr. p. 89, lines 3-12—is immaterial—even if supported by the facts (which it is not)—because the Referee properly ruled that “any action based on Section 60 (Bankruptcy Act) Preferences” was barred by the two (2) year statute of limitations prescribed by Section 11(e) of the Bankruptcy Act.)

(b) *The \$20,000.00 Exchange of Checks.*

On January 26, 1961—five (5) days before Bankrupt (1) started to do business or (2) had any creditors—Appellant caused a corporation (Holmby-Sunset) to deliver a \$20,000.00 check to Bankrupt—which cashed the same on January 30, 1961 (the day it commenced to do business).

At the same time, on January 26, 1961, Bankrupt delivered two(2) “post-dated (February 4 and 13, 1961) checks” for \$10,000.00 (each) to Appellant—which checks were cashed by Appellant, on February 8, 1961 (February 4 check) and February 20, 1961 (February 13 check). [Tr. p. 86, lines 18-30.]

The only testimony relating to why this exchange of checks occurred was, in substance, that a Steve Dadigan and Appellant were, originally, to become 50% stockholders of Bankrupt and Dadigan was to advance \$20,000.00 and Appellant the \$42,000.00 (by transferring six—\$7,000.00—second trust deeds to McDaniels Market). That Dadigan could not—in the latter part of January, 1961—put up his \$20,000.00 and he asked Appellant to “temporarily” advance it for him (until he returned from a trip to Mexico). Appellant did so with the understanding it would be repaid on February 4 (\$10,000) and February 13 (\$10,000). [Ex. N, pp. 25-29, Ex. M, pp. 46-48, p. 112, Rep. Tr. pp. 46, 48, 136 and 234 and Creditors’ Ex. 16.]

Originally [Tr. p. 36, lines 28-32; p. 37, lines 1-18], Appellee sought to recover this \$20,000.00—from Appellant—on the theory of a Section 60 Preference—but abandoned this approach when the Referee properly ruled [Rep. Tr. pp. 24-28] that Section 11(e) of the Bankruptcy Act (Act) barred the use of the “Section 60 Preference” approach.

At the Referee’s suggestion [Rep. Tr. pp. 28-29], Appellee adopted the “Director’s preference” theory and, on September 11, 1963, amended his application. [Tr. pp. 57-62.] On this theory, Appellee contended that he was entitled to the return of this \$20,000.00 because Appellant—as the person in control of Bankrupt—did cause a *constructive fraud* to be committed on the *other creditors* of Bankrupt by—in bad faith—having the latter pay Appellant \$10,000.00 on February 8, 1961, and February 20, 1961—when Bankrupt was insolvent and Appellant knew (or had reasonable cause to know) that Bankrupt was insolvent (to the detriment of other creditors).

In an attempt to sustain his burden of proving “insolvency”—on February 8 (nine days after business commenced) and on February 20 (21 days after business commenced)—Appellee used a Certified Public Accountant (Thomas Mulherin—called “Accountant”), who orally testified and also prepared a written report. [Rep. Tr. pp. 170-224 and Ex. S.]

Appellee did *not* introduce any evidence which would have established the following:

- (a) The fair market value—on February 8 or February 20, 1961—of any of the assets or any of the following specific assets of Bankrupt:
 - (1) Inventory [Rep. Tr. p. 221, lines 25-26];
 - (2) Wine and beer license;
 - (3) Sublease;
 - (4) Cash—on hand and in a Bank;
 - (5) Equity in Santa Ana apartment buildings;
 - (6) Bankrupt’s right to purchase McDaniels Market’s fixtures, machinery, etc.;
- (b) The actual amount of outstanding indebtedness and liabilities on February 8 or February 20, 1961—and how much thereof was “matured” on those days (*i.e.*, for example, the Accountant “determined” [Ex. S, p. 2] a \$55,500.00 “loss” in connection with the \$60,000.00 note given to Appellant (February 2, 1961) for grant deed to Santa Ana apartments. Assuming, *arguendo*, this note was an “indebtedness”, the fact remains that it was *not* “due” or “matured” on either February 8 or February 20, 1961. [Rep. Tr. p. 213, lines 15-23, Ex. M, p. 98, lines 1-10.]

- (c) What Bankrupt's "matured" debts were on February 8 and February 20, 1961, and whether Bankrupt had—on those dates—sufficient assets to pay them.

In other words, Appellee introduced no "evidence" to sustain his burden of proving "insolvency"—on February 8 or February 20, 1961—in either the "equity" or "bankruptcy" sense.

The only "evidence" Appellee produced on this issue (*upon which Appellee had the burden of proof*) was the testimony of Accountant. [Rep. Tr. pp. 170-224 and Ex. S, pp. 1-4.]

Appellant points out that Accountant was not qualified—by Appellee—as an appraiser and he admitted [Ex. S, 2nd and 3rd pars. of p. 1) that (a) he couldn't state what the condition of Bankrupt was on the key dates (February 8 and 20, 1961) and (b) he couldn't determine—on those dates—what Bankrupt's "obligations and inventory" were [also see Rep. Tr. pp. 221-224].

As a matter of fact, the Accountant's testimony and conclusions were founded on one "premise", to wit:

That Bankrupt had about a \$55,000.00 loss on its "purchase" of the Santa Ana apartments.

[Rep. Tr. p. 224, lines 4-9 and Ex. S, pp. 1-4.]

This testimony (and conclusion) of Accountant ignores all of the following facts:

- (1) The Referee had—on July 26, 1962—held that Appellant did *not* "sell" the Santa Ana apartments to Bankrupt, but had made a "capital contribution" thereof to Bankrupt [Tr. p. 30, lines 14-19];

- (2) That the only testimony *re* fair market value (and equity) of the Santa Ana apartments—on February 8 and February 20, 1961—was the testimony of Appellant that—in his opinion—Bankrupt had an “equity” (over and above the first deed of trust of \$25,000.00 and the second deed of trust of \$7,000.00) of about \$5,000.00 to \$6,000.00 in *each* of the six (6) Santa Ana apartment buildings [Rep. Tr. pp. 315-316]. In other words, the only “testimony” in this record (as distinguished from Accountant’s statement that Appellee (and Appellee’s attorney) told him the “only value to the Bankrupt * * * that could be attributed to the property would be the rents (collected by Bankrupt)” —see Exhibit S, p. 2) was Appellant’s testimony that Bankrupt had an “equity” of from \$30,000.00 to \$36,000.00;
- (3) Appellant had “contributed capital” of, at least, \$42,000.00 and \$30,000.00 (represented by inventory and Santa Ana apartments) *on or about January 11 and February 7, 1961*, respectively, and Bankrupt certainly had “cash” in banks and on hand, it had a beer and wine license, and it had a sublease on both February 8 and February 20, 1961;
- (4) No evidence was introduced as to any “indebtedness” of Bankrupt on either February 8 or February 20, 1961, and Appellee disclosed Bankrupt’s expenses “through February 20, 1961” only amounted to about \$6,700.00 [Ex. S, p. 3];
- (5) Appellee disclosed that Bankrupt had a “gross profit” of about \$15,500.00 through February

13, 1961, and of about \$21,500.00 through February 20, 1961 [Ex. S, p. 4];

- (6) Once you treat the \$42,000.00 of inventory acquired with Appellant's six trust deeds and the equity in the Santa Ana apartments as "contributions to capital"—as distinguished from indebtedness—[Tr. p. 30, lines 14-26] you couldn't possibly have "insolvency" *in any sense*—on either February 8 or February 20, 1961;
- (7) That it is immaterial that the holder of the first deeds of trust—on the Santa Ana apartments—"wiped out" every one at its Trustee's sale *on December 15, 1961* [Rep. Tr. pp. 257-261.]

The record is clear to the effect that Appellant gave a "fair consideration" for this \$20,000.00 (*i.e.*, he gave \$20,000.00 on January 26, 1961). [Creditor's Ex. No. 16.]

Appellant also points out that Accountant ignored the fact that Bankrupt took an inventory *on February 9, 1961* [Creditor's Ex. 9 and Ex. M, p. 151] and, further, that *on March 6, 1961* (11 days after the Sheriff and Appellee "took over"), Bankrupt still had a "retail" inventory of about \$80,000.00 (\$57,000.00 wholesale)—*after* the Sheriff had sold \$9,000.00 and Appellee had sold \$11,000.00 thereof (between February 24 and March 6, 1961) [Ex. S, pp. 8 and 11] and, further, that *on February 28, 1961*, an offer of about \$90,000.00 (exclusive of cash, accounts receivable and credits) was made for Bankrupt's inventory, etc. [Tr. pp. 12 and 17-20.]

Appellee introduced no evidence whatsoever to prove:

- (1) Insolvency in the bankruptcy sense.

By showing that liabilities—on February 8 and February 20, 1961—exceeded assets—on those same dates;

or

- (2) Insolvency in the equity sense.

By showing that—as of February 8 or February 20, 1961—Bankrupt's "current and matured debts" could not—on those dates—be paid with the assets on hand;

(c) *The \$28,000.00 withdrawn—by Appellant—on February 20, 1961.*

On February 20, 1961, Appellant withdrew \$28,000.00 belonging to Bankrupt.

The only testimony as to why Appellant withdrew this money is that given by Appellant—*i.e.*, that it was done to "protect" bona fide creditors of Bankrupt from a threatened improper attachment—by Steve Dadigan. [Ex. M, pp. 44-45, 66-67, 76-88, Transcript of Dr. Hassen's 21a Examination on July 27, 1961, pp. 35-37.]

There is no conflict in the record (and Appellee admits it and the Referee so "found") that Appellant *returned* this \$28,000.00 (plus \$2,000.00) on the following dates:

(1) February 21, 1961	\$14,000.00
(2) February 23, 1961	\$ 8,000.00
(3) March 1, 1961	\$ 8,000.00
	<hr/> \$30,000.00

Further, that the \$30,000.00 was used to pay “bona fide creditors” of Bankrupt. [Rep. Tr. p. 198, lines 9-12, and pp. 225-243; Ex. M, pp. 136-142; Ex. N, pp. 18-24.]

The referee—with affirmation by the United States District Court—held that Appellant was not entitled to “offset” the “return” of the \$28,000.00 because:

- (1) It (the withdrawal on February 20, 1961) was a transfer made in violation of the California Uniform Fraudulent Conveyance Act [Tr. p. 90, lines 2-9];
- (2) The “return” to Bankrupt (\$22,000.00 (on February 21 and 23) direct and \$8,000.00 (on March 1, 1961) to its creditors) benefited only creditors of Pomona Properties, Inc. (before bankruptcy) and not “creditors of the bankruptcy estate” (*i.e.*, Sec. 60 preference—which the Referee had previously ruled *not* applicable) [Tr. p. 89, lines 3-10].

Appellant contended (and it is the only evidence as to why the \$28,000.00 was withdrawn):

- (1) That he withdrew the \$28,000.00 to “protect” creditors from a threatened improper and unfounded attachment by Steve Dadigan (President, Director and 50% stockholder of Bankrupt—who “ran” Bankrupt for “two or three weeks”—of its 24-day existence) [Ex. M, pp. 44-45, 66-67 and 76-88 and pp. 35-37 of the Transcript of Appellant’s 21a Examination of July 27, 1961];
- (2) In any event—with Sec. 60 preference theory being barred by Sec. 11(e) of the Act—Appellant having returned \$22,000.00—within three

(3) days of the withdrawal—and the remaining \$6,000.00 within 11 days of the withdrawal—and all \$28,000.00 being used to pay “*bona fide general creditors*,” it was immaterial whether the “February 20, 1961” withdrawal was or was not made in violation of the California Fraudulent Conveyance Act (Sec. 3439, *et seq.* of the California Civil Code).

C. STATEMENT OF THE CASE.

This appeal presents, for the determination of this Court, the following questions:

I.

Did the United States District Court—partially affirming an Order of a Referee in Bankruptcy—err in ruling that Appellant was only entitled to “offset” \$1,400.00 (of about \$5,599.95) against rents of \$5,400.00 (which Appellant admits he improperly collected)?

This was placed in issue by the First Cause of Action of the amended application and Appellant’s answer thereto. [Tr. pp. 57-59 and pp. 63-64.]

II.

Did said District Court—affirming an Order of a Referee in Bankruptcy—err in ruling that Appellant had to return \$20,000.00 to Bankrupt Estate—on the theory Appellant had committed a constructive fraud on other general creditors of the Bankrupt Estate?

This was placed in issue by the Second Cause of Action of the amended application and Appellant’s answer thereto. [Tr. pp. 59-60 and pp. 64-66.]

III.

Did said District Court—affirming an Order of a Referee in Bankruptcy—err in ruling that Appellant had to return—for a “second” time—\$28,000.00 (withdrawn from Bankrupt’s bank account on February 20, 1961] on the theory that the withdrawal was a “fraudulent” transfer within the California Uniform Fraudulent Conveyance Act—even though Appellant returned said \$28,000.00 and it was used to pay general creditors of Bankrupt?

This matter was placed in issue by the Third Cause of Action of the amended application and Appellant’s answer thereto. [Tr. pp. 60-61 and p. 66 (including “off-set”).]

IV.

In any event, did said District Court err in not ruling that Appellant would be entitled to file a claim—as a general creditor—if and when he paid the said \$20,000.00 and \$28,000.00?

This matter was interjected into the case by the said District Court during the argument before that Court. [Tr. Vol. II, pp. 12-18.]

Appellant contends:

- (a) He is entitled to “offset” the \$5,599.95 he furnished—to general creditors of Bankrupt (through Jack Goldsmith) *after bankruptcy*—against the \$5,400.00 of rents he collected—*after bankruptcy*;
- (b) He did not commit any constructive fraud against general creditors of the Bankrupt Estate in cashing the two (2) \$10,000.00 checks;
- (c) He should not be required to return—for a *second time*—the \$28,000.00 he withdrew on February 20, 1961.

D. ASSIGNMENT OF ERRORS.

The Appellant assigns as error the following acts or omissions of the said United States District Court (and the Referee in Bankruptcy):

- (1) In ruling that Appellant was not entitled to offset the entire \$5,599.95—Appellant paid (through Jack Goldsmith)—*after* bankruptcy—to general creditors of the Bankrupt Estate—against the \$5,400.00 of rents he collected *after* bankruptcy;
- (2) In ruling that Appellant committed a constructive fraud—against creditors of Bankrupt Estate—by cashing the two (2) “exchange” checks for \$10,000.00 (each);
- (3) In ruling Appellant had to return—*for a second time*—the \$28,000.00 he withdrew on February 20, 1961, from Bankrupt’s bank account;
- (4) In ruling that if Appellant returned the \$20,000.00 and \$28,000.00 he could file a claim—*within 30 days of the said Court’s Order of July 9, 1965*—as a general creditor for the \$20,000.00—but not for the \$28,000.00.

E. ARGUMENT.

I.

**Appellant Was Entitled to an “Off-Set” of \$5,599.95
Against the \$5,400.00 of Rents Collected by Ap-
pellant.**

The bankruptcy proceedings herein commenced on March 1, 1961—with the filing of the Petition (Involuntary) in Bankruptcy and appointment of Appellee as Receiver [Tr. p. 77, lines 15-23]. Therefore, Appellant, in this brief, refers to all transactions occurring—on and after March 1, 1961—as occurring “after bankruptcy”.

Appellant admittedly collected \$5,400.00 of rents—from Santa Ana apartments (deeded to Bankrupt on or about February 7, 1961)—*after* bankruptcy. However, everyone agrees that Appellant returned—*after* bankruptcy—the following:

- (a) \$2,000.00 (out of \$8,000.00) on March 1, 1961;
- (b) \$1,400.00 between May 16 and 25, 1961 (\$900.00—\$400.00—\$100.00);

Further, Appellant submits that the uncontradicted evidence, in the record, also discloses that Appellant also returned the following (*between March 1 and 16, 1961*):

\$ 644.96

469.20

585.85

500.00

\$2,199.95 [Ex. N, pp. 20-21].

Appellant also submits that the uncontradicted (and only evidence) evidence discloses that this \$5,599.95 was used to pay “creditors of the estate”—and *after* bankruptcy [Ex. N, pp. 18-24, Ex. M, pp. 136-162, Exs. I and J and Rep. Tr. pp. 240-256].

Appellant is talking about the right of “off-set” of \$5,599.95 given, in effect, to Bankrupt—*after* bankruptcy—against \$5,400.00 taken, in effect, from Bankrupt—*after* bankruptcy. Thus we are *not* talking strictly about set-offs under Section 68 of the Bankruptcy Act.

See:

Bankruptcy Act, Section 68;

Collier—Bankruptcy Manual—§§68.04, 68.08 and 68.12;

9 Am. Jur. 2d, p. 396 [Bankruptcy §511].

However, as stated in Collier's Bankruptcy Manual, at page 904:

"The doctrine of subrogation may be implied to permit a set-off, so that a third party who has paid the bankrupt's debt and has taken into his possession property held as security may offset the amount of the debt so paid against the claim of the trustee for the property."

Also see:

In re Rudd, 180 Fed. 312;

9 Am. Jur. 2d, p. 397 [Bankruptcy §512];

44 Cal. Jur. 2d, p. 634;

In re Field Heating & Ventilating Co., 201 F. 2d 316 (CCA-7).

Appellant submits there is no difference between the \$900.00 (allowed by the Referee as a set-off) or the \$1,400.00 (allowed by said District Court as a set-off) and the entire \$5,599.95 (of which said \$900.00 or \$1,400.00 are a part) which Appellant is claiming as a set-off.

II.

**Appellant Did Not Commit Any Constructive Fraud
— Against General Creditors of the Bankruptcy — by Cashing the Two (2) \$10,000.00
Exchange Checks.**

At the outset Appellant points out that Appellee was forced to amend his application (involved herein) to, in effect, plead a "director's preference" within the alleged purview of cases like *Bonney v. Tilley*, 109 Cal. 346, and *T.I.T. Co. v. Calif. Develop. Co.*, 171 Cal. 173, because:

- I. Sec. 11(e) of the Bankruptcy Act barred any recovery—under the theory of “preference”—under Sec. 60 of the Bankruptcy Act; and
- II. No recovery could be had under Sec. 67(d) of the Bankruptcy Act or the California Uniform Fraudulent Conveyance Act (Sec. 3439, *et seq.*, of the California Civil Code) because:
 - (a) Appellant has paid a 100% consideration (let alone a “fair consideration”) for these two (2) \$10,000.00 checks; and
 - (b) Appellant had caused the checks to be issued on January 26, 1961—five (5) days before Bankrupt commenced business (on January 30, 1961) or had *any* creditors.

Faced with this situation, Appellee—at, we respectfully submit, the Referee’s suggestion—turned to Section 70 of the Bankruptcy Act and adopted a new theory of “constructive fraud” under California law, to wit:

The Referee, having ruled—on July 26, 1962 (about 14 months before application amended and in connection with hearings on Appellee’s objections to Appellant’s claims)—that Appellant was “the person in control of Bankrupt”, properly accepted that ruling as binding on the parties herein (*res adjudicata* or collateral estoppel).

Therefore, Appellee plead (by amended application of 9/11/63) that Appellant—as the dominant person in control of Bankrupt—committed a “constructive fraud” on other general creditors of the estate by having his two (2) “10,000.00 exchange checks” paid—on February, 8, 1961, and February 20, 1961—at a time when

Bankrupt was allegedly "insolvent" and to the detriment of such creditors.

Appellant, by his answer [Tr. pp. 64-65], in effect, contended:

- (a) The exchange of checks occurred on January 26, 1961 (before Bankrupt had commenced business and before it had *any* creditors) and, in entire good faith, as an accommodation to Bankrupt—pending Steve Dadigan putting up this \$20,000.00;
- (b) In any event, Bankrupt was *not* insolvent on February 8 and February 20, 1961—when the two (2) \$10,000.00 checks were cashed.

Under the uncontradicted facts hereinbefore set forth, there can be no question as to the circumstances surrounding the execution of the two (2) \$10,000.00 checks. Further, the record is uncontradicted as to the following receipts by Appellant (from Bankrupt's funds) and the following payments by Appellant—to or for the benefit of Bankrupt (or its creditors):

<u>Amount Received by Dr. Hassen</u>	<u>Date</u>	<u>Amount Given by Dr. Hassen</u>	<u>Date</u>
		\$20,000.00	1-26-61
		42,000.00	Prior to 1-30-61
\$10,000.00	2-8-61		
10,000.00	2-20-61		
28,000.00	2-20-61		
		14,000.00	2-21-61
		8,000.00	2-23-61
		8,008.67	3-1-61
		2,199.95	3-1-61
			3-16-61
\$5,400.00 (rents)	May-July, 1961		

In other words—and without taking into consideration the order involved herein (requiring Dr. Hassen to return an additional \$52,500.00), we find that Dr. Hassen has already contributed about \$94,200.00 (for the benefit of Bankrupt's creditors), while—in the manner hereinabove set forth—he has withdrawn \$53,400.00.

If the Referee's Order of December 11, 1964, is allowed to stand, Dr. Hassen would be \$94,000.00 net out of pocket (\$146,700-\$53,400.00).

Appellant respectfully submits that the facts of this case are a “far cry” from the facts presented to the Court in the *Bonney* and *T.I.T. Co.* cases, *supra*, to wit:

1. In both of said cases the corporation involved was clearly “insolvent” and the “controller” knew it was insolvent;
2. In the *Bonney* case, a director bought up corporate obligations at 10c on the dollar and then tried to collect 100% of face value “to the detriment of other creditors”. EVEN IN THAT CASE, THE COURT ALLOWED THE DIRECTOR TO SHARE “PRO RATA” WITH THE OTHER CREDITORS;
3. In the *Title Insurance and Trust Company* case, a railroad company went into Mexico and “fraudulently” had a “collusive judgment” entered in favor of one of its 100% subsidiaries against another one of its 100% subsidiaries. Even in that case the Court again held that the railroad company had the right to share “pro rata” with other creditors of California Development Company.

In our case, we do not have “insolvency” on either February 8 or February 20, 1961 (the dates of cashing of checks) and, in addition, Dr. Hassen paid 100% for his two \$10,000.00 checks (\$20,000.00). Secondly, the circumstances under which the said checks were exchanged are a far cry from the facts of *Bonney* or *Title Insurance and Trust Company*.

In any event, Appellee has *not* established that Bankrupt *was insolvent* on either of two days when these \$10,000.00 checks were cashed—*i.e.*, on *February 8 or February 20, 1961*.

In both the *Bonney* and *T.I.T. Co.* cases, *supra*, the “person” in control of the debtor corporation *acting in bad faith*—knowing that the debtor corporation (involved in those cases) was hopelessly insolvent—entered into a course of conduct that “he” knew would be to the detriment of the bona fide creditors and for his “sole” benefit.

Let us compare the present case with those cases:

On January 26, 1961—and as a temporary advance under circumstances that can only indicate *good faith*—Appellant caused Holmby-Sunset to advance \$20,000.00 and, in turn, took back two (2) \$10,000.00 checks—post-dated about one week (2/4) and two weeks (2/13).

Appellant had already furnished Bankrupt the equivalent of \$42,000.00 in cash (*i.e.*, six trust deeds used to pay for \$42,000.00 of \$55,000.00 of McDaniel Market inventory—Creditors’ Exhibit No. 6, Exhibit M, p. 151) (in other words, the only “working capital” Bankrupt had was the \$62,000.00 thus furnished by Appellant [Tr. p. 11, pp. 15-24]).

On February 9, 1961 (one day after first \$10,000.00 exchange check cashed), an inventory was taken disclosing about \$50,000.00 of inventory on hand [Creditors' Ex. 7 and Ex. M, p. 151].

According to Exhibit S, pp. 3-4, the Bankrupt realized the following "gross profits" from sales:

- (a) Through February 4, 1961—\$6,331.00
- (b) Through February 13, 1961—\$15,595.00
- (c) Through February 20, 1961—\$21,579.00

On *February 24*, 1961, the Bankrupt was "taken over" by the Sheriff (because of an attachment) and *the Appellee* "took over" from the Sheriff on March 1, 1961.

Between February 24 and February 28, 1961, the "Sheriff" sold about \$9,200.00 of "inventory" [Ex. S, p. 8] and *the Appellee* sold \$11,337.19 of "inventory" between March 1 and March 6, 1961 [Ex. S, p. 11].

However, *on March 6, 1961*, the Appellee still had, in his possession and control, \$80,000.00 (at retail)—\$57,000.00 at wholesale—*of inventory* (in addition, he had sublease, beer and wine license, cash, accounts receivable, credits, etc.).

On February 28, 1961, a Mr. Hirata offered [Tr. pp. 17-19] the equivalent of \$90,000.00 *to Pomona Properties, Inc.* for "its business".

Bearing in mind there has been "no evidence" offered by Appellee—in support of its burden of proving insolvency (9 Am. Jur. 2d p. 783 (Bankruptcy §1055)) in the "equity" sense—*i.e.*, Bankrupt could not on February 8, 1961 (tenth day of operation) and February 20, 1961 (20th day of operation) pay its "*current* obliga-

tions as they became due”—Appellant respectfully submits that there is *no evidence* to support the Referee’s finding that—*on February 8 and February 20, 1961*—“Appellant knew and had reasonable cause to believe the Bankrupt was insolvent” [Tr. p. 87, lines 20-22].

The foregoing facts would—Appellant respectfully submits—indicate to any ‘reasonable person’ *on February 8 and February 20, 1961* that Pomona Properties, Inc. (now Bankrupt) was “solvent”—let alone to have “reasonable cause to believe the Bankrupt was insolvent”.

Appellant—the uncontradicted evidence discloses:

- (a) Acted in entire “good faith” in exchanging these checks [Ex. N, pp. 25-29, 32; Rep. Tr. pp. 46 and 48, 136; Ex. M, pp. 124-128];
- (b) Knew that there weren’t *any* creditors on January 26, 1961 (when checks “exchanged”);
- (c) On February 8 and February 20, 1961—when checks cashed—had no reason—under the foregoing facts—to believe that Pomona Properties, Inc. was “insolvent” in any “sense” of the word.

To the contrary, the foregoing evidence clearly indicates—Appellant respectfully submits—that *if* the other creditors of Pomona Properties, Inc. had been “reasonably patient” they would have avoided a “distressed or forced sale” and been paid 100¢ on the dollar [Rep. Tr. pp. 48-53].

See:

Cowan’s—Bankruptcy Law and Practice—§751, pp. 397-398 (and cases in footnote).

In spite of the quantities of inventory on hand (plus cash, sublease, beer and wine license, accounts receiv-

able, etc.), the Appellee finally realized—at a “distress or forced sale”—only about \$27,500.00 on July 12, 1961 [Tr. p. 23, lines 3-9]. *Query?* What happened to the approximately \$57,600.00 of *wholesale* inventory of March 6, 1961 [Ex. S, p. 11]?

Let us now analyze the finding of the Referee that Pomona Properties, Inc. was insolvent on February 8 and on February 20, 1961 [Tr. p. 86, line 32, and p. 87, lines 1-18].

The Court will note that the Referee “found” *insolvency* as defined by the Bankruptcy Act (§§1(19) and 67(d)(1)(d)) and the California Uniform Fraudulent Conveyance Act (Sec. 3439, *et seq.* of the California Civil Code—specifically Sec. 3439.02(a)).

Thus our problem is to determine whether Pomona Properties, Inc.—*on either February 8 or February 20, 1961*—(1) was in the position that its liabilities exceeded the fair “market or saleable” value of its assets or (2) whether the fair saleable or market value of its assets was not sufficient to pay its *current matured* debts.

Appellant believes that the former question presents “insolvency” in the “bankruptcy sense” and the latter presents it in the “equity sense”.

See:

Cowan—Bankruptcy Law and Practice—p. 25 (§25);

9 Am. Jur. 2d, “Bankruptcy” §§1065, 1066 and 1113.

Inasmuch as Appellee—with the burden of proving “insolvency” (9 Am. Jur. 2d, Bankruptcy §1055, pp. 783-784 and §§1185-1187, pp. 880-882)—*did not at-*

tempt to introduce any evidence as to whether Pomona Properties, Inc. was “insolvent” in the *equity* sense (*i.e.*, could not pay its *current mature* bills on February 8 and February 20, 1961), we are concerned here only with Appellee’s attempt to prove “insolvency” in the “bankruptcy sense” (*i.e.*, balance sheet test of assets vs. liabilities)—on February 8, 1961, and on February 20, 1961.

Appellee relied entirely upon the testimony and report of a Mr. Mulherin (called “Accountant”)—a Certified Public Accountant.

Appellee did *not* introduce *any* evidence of the “fair-market value” or “fair saleable value” of the assets of Pomona Properties, Inc. on February 8 or February 20, 1961—with the exception that:

- (a) He did introduce evidence that Pomona Properties, Inc. did have from \$30,000.00 to \$36,000.00 of equity—on February 8 and February 20, 1961—in the Santa Ana apartment buildings [Rep. Tr. pp. 315-316];
- (b) Over objection of Appellant [Rep. Tr. pp. 257-261], Appellee did introduce documents referring to a “liquidation sale” (nine or ten months *after bankruptcy*) by the Trustee of the *first deeds of trust* on the Santa Ana apartment buildings [Ex. GG].

Appellee introduced *no evidence* as to the fair market value or fair saleable value of the following specific assets of Pomona Properties, Inc.—on February 8 or February 20, 1961:

1. Cash—on hand and in banks;
2. Inventory;

3. Sublease;
4. Accounts receivable;
5. Credits;
6. Option to purchase (from McDaniel Markets) fixtures, equipment and machinery;
7. Beer and wine license.

On the other hand, Appellee introduced *no evidence* as to amount, type or kind of current, mature liabilities (or any other type of liabilities) of Pomona Properties, Inc.—on February 8 and February 20, 1961—other than:

- (a) Reference was made to February 2, 1961, promissory note of \$60,000.00 and the January 11, 1961, promissory note for \$42,000.00 [Creditors' Exs. 1 and 2; Ex. M, pp. 61-62];
- (b) A report of Accountant was introduced as Ex. S—which referred to “alleged” losses and expenses—but did *not* refer to any liabilities.

There was *no evidence* introduced that Appellant had—on either February 8 or February 20, 1961—made a “demand” for payment of either of said promissory notes. To the contrary, Appellant testified that the \$60,000.00 note was “only to be paid when Pomona Properties, Inc. could pay same.” [Ex. M, p. 98, lines 1-10].

Furthermore, Appellee has overlooked the fact that the \$60,000.00 was really not an obligation (or liability) *on February 8 or February 20, 1961*, because:

The Referee found (7/26/62) that the \$60,000.00 and \$42,000.00 were “contributions of capital” [Tr. p. 30, lines 14-26] and did not arise out of a sale or loan, respectively, to Pomona Properties, Inc.

See:

9 Am. Jur. 2d, Bankruptcy, Sec. 1189, pp. 883-884;

[Rep. Tr. p. 5, lines 3-18].

The “foundation” of the unqualified conclusion given by the Accountant herein is the erroneous premise that Bankrupt had—on February 8 and February 20, 1961—a \$55,500.00 “loss” in connection with its purchase of Appellant’s “equity” in the Santa Ana apartments [Ex. S, pp. 1-2, and Rep. Tr. p. 214, line 25, to p. 224, line 9].

A mere reading of Exhibit S [pp. 1-4] and the Accountant’s testimony [Rep. Tr. pp. 59-71, 138-224] will disclose that—although he understood that “excess of liabilities over assets” indicated “insolvency” [Rep. Tr. p. 65, lines 16-23], the Accountant never actually made any attempt to *even list* the assts and liabilities (as of February 8 and February 20, 1961—let alone attempt to fix their amounts.

The Court will recall that Pomona Properties, Inc.—at all times up to March 6, 1961 (six (6) days *after* bankruptcy) had very substantial “assets”—to wit:

- (a) Cash—in banks and on hand (we know there was, at least, \$28,000 on February 20, 1961—*i.e.*, Appellant obtained \$28,000 on February 28, 1961);
- (b) Inventory (\$80,000 at retail, *as late* as March 6, 1961—*after Sheriff sold \$9,200 and Appellee had sold \$11,000*;
- (c) Equity in Santa Ana apartments (Appellant testified from \$30,000 to \$36,000);
- (d) Beer and wine license;

- (e) Option to purchase fixtures, etc.;
- (f) Lease and sublease;
- (g) Accounts receivable;
- (h) Credits.

(Even *after* the Sheriff “took over” on February 24, 1961, Hirata offered about \$90,000.00 for everything “except cash, accounts receivable and credits” [Tr. pp. 17-19].)

Therefore, Appellant respectfully submits that Appellee did *not* bring himself within the purview of the doctrine of the *Bonney* and *T.I.T. Co.* cases, *supra*, in that:

- (a) The “exchange of checks”—and the cashing thereof on February 8 and February 20, 1961—took place under circumstances that indicated “complete good faith” on the part of Appellant;
- (b) Appellant paid a 100% (let alone a fair consideration) consideration for the two (2) \$10,000.00 checks;
- (c) Appellant had no reason to believe—and no evidence was introduced to show Appellant so knew or had cause to so believe—(on February 8 or February 20, 1961) that Pomona Properties, Inc. was “insolvent” because
- (d) Pomona Properties, Inc. was *not* insolvent—on those dates—and *no evidence* was introduced in any attempt to so prove such insolvency.

Appellant respectfully submits that the orders—requiring return of the said \$20,000.00—should be reversed.

III.

Appellant Should Not Be Required to Return—for a Second Time—the \$28,000.00 He Withdrew on February 20, 1961.

The record herein is clear as to the following:

- (1) Appellant withdrew \$28,000.00 on February 28, 1961, from Bankrupt's bank account;
 - (2) Appellant repaid said \$28,000.00 as follows:
 - \$14,000.00—February 21, 1961
 - \$ 8,000.00—February 23, 1961
 - \$ 8,000.00—March 1, 1961
- [Tr. p. 74, lines 2-9, p. 88, lines 13-21].

The Appellee—as aforesaid—first attempted to recover this \$28,000.00—for a second time—on the theory of a Section 60 preference. When the Referee properly ruled that “preference recovery actions” were barred by the provisions of Section 11(e) of the Bankruptcy Act, Appellee proceeded on a theory that Appellant—frankly—does not understand (*i.e.*) that the withdrawal—on February 20, 1961—constituted a fraudulent “transfer” within the purview of Sections 3439, *et seq.* of the California Civil Code.

We may assume, *arguendo*, that the “withdrawal” constituted such a “transfer” and—if it had not been repaid (as aforesaid)—Appellee could have proceeded for recovery under either 67(d) of the Bankruptcy Act or said 3439, *et seq.*, of the California Civil Code.

However, Appellant did repay the \$28,000.00 (plus \$2,000.00)—within ten days of withdrawal—and the repayments were used to pay “bona fide creditors”. (It is true that Appellee—or “creditors of estate”—[Tr. p. 89, lines 3-10]—did not receive this \$30,000.00,

but that is not material because a "Sec. 60 preference action" was not commenced within two (2) years of adjudication).

The Referee—with the said District Court affirming—*relying upon Section 3439.07 of the California Civil Code*, concluded that Appellant had to return the \$28,000.00 *for a second time* [Tr. p. 90, lines 11-15].

The Referee—with the said District Court affirming—also said that the *original (or first)* return of the \$28,000.00—by Appellant—was immaterial, citing:

23 Cal. Jur. 2d, p. 545, note 14 (1964 Supp.);

Hickson v. Thielman, 147 Cal. App. 2d 11, 304 P. 2d 122;

[Tr. p. 74, lines 2-18].

Appellant respectfully submits that the citations (relied upon by the Referee, *supra*, merely hold:

- (1) If a transferee (receiving a "fraudulent transfer") merely transfers the same back to *his transferor (without any benefit to transferor's creditors)*, then, and only then, is he not relieved of his liability (under the California Fraudulent Conveyance Act).

However, *if* such a "transferee" returns the "transfer" to the creditors (or for their benefit)—*as happened in the present case*—then the "transferee" has no further liability to "creditors of the transferor".

See:

Hickson v. Thielman, 147 Cal. App. 2d 11, 304 P. 2d 122;

23 Cal. Jur. 2d, pp. 540-545 (§§ 94-100);

Sec. 68(a), Bankruptcy Act.

We have—up to this point—been assuming, *arguendo*, that Appellant withdrew the \$28,000.00 “with intent to delay, etc., creditors”—as found by the Referee [Tr. p. 88, lines 13-18]. However, we again refer to the uncontradicted evidence, in this record, to the effect that Appellant withdrew the \$28,000.00—on February 20, 1961—to “protect” bona fide creditors of Bankrupt and to defeat Steve Dadigan’s *threatened improper* “attachment” [Ex. M, pp. 76-78].

(In addition, we call the Court’s attention to the inferences that must be drawn from the fact that on February 21, 1961, Appellant returned \$14,000.00, on February 23, 1961, he returned \$8,000.00 and \$8,000.00 was returned on March 1, 1961—all of which was used to pay “Creditors”.)

Appellant respectfully submits that he should not—under these circumstances—be required to return the \$28,000.00 “for a *second* time”.

IV.

In Any Event, Appellant Is Entitled to File a Claim—as a General Creditor—if He Is Required to Return the \$20,000.00 and \$28,000.00.

The Referee—in directing the return of the said \$20,000.00 and \$28,000.00—was silent *re* Appellant’s right—if such return was made—to file a claim as a general creditor [Tr. p. 89, lines 26-32 and p. 90]. However, the United States District Court—in its order of affirmance—ruled that Appellant could file as a general creditor (if he returned *the* \$20,000.00—but not the \$28,000.00), *provided* the \$20,000.00 was paid *within 30 days of July 9, 1965* [Tr. p. 125, lines 2-8].

(We note that the Hon. William M. Byrne did not—at the June 29, 1965, hearing—refer to any “30-day period” [Tr. Vol. II, pp. 12-18].

Appellant submits that *if* (contrary to Appellant’s position herein) the Court should affirm the order to return the \$20,000.00 and/or the return of the \$28,000.00, then, and in that event only, Appellant should be allowed—within 30 days after finality of ruling of this Court—to pay such amounts and file a claim—as a general creditor—for the entire amounts so paid.

See: 9 Am. Jur. 2d (Bankruptcy, §454), p. 353.

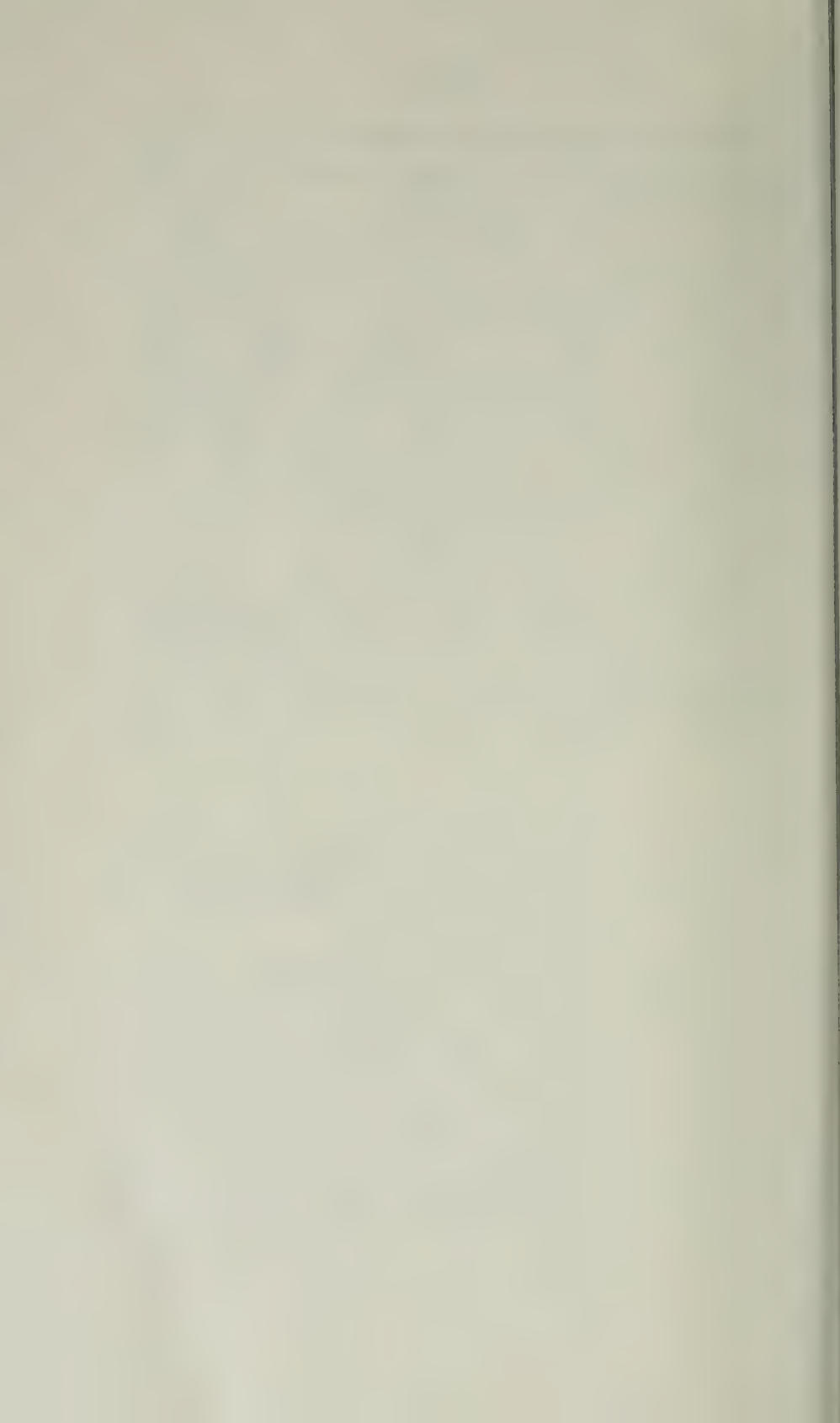
Conclusion.

Appellant respectfully submits the Order of July 9, 1965, of the said United States District Court—and the Order of the Referee of December 11, 1964, which it basically affirmed—should be reversed.

Dated: November 29, 1965.

Respectfully submitted,

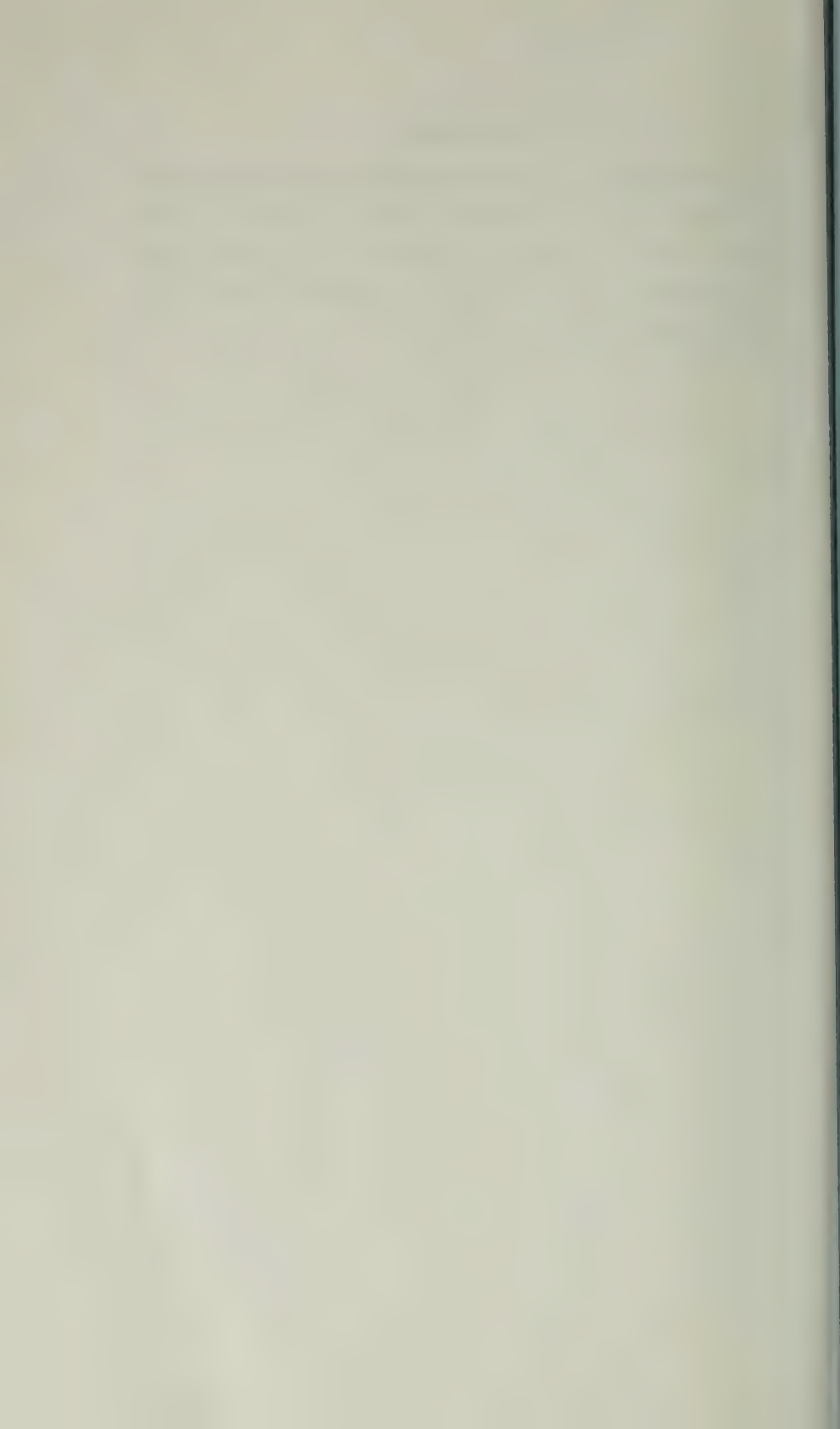
JAMES J. ARDITTO,
Attorney for Appellant.



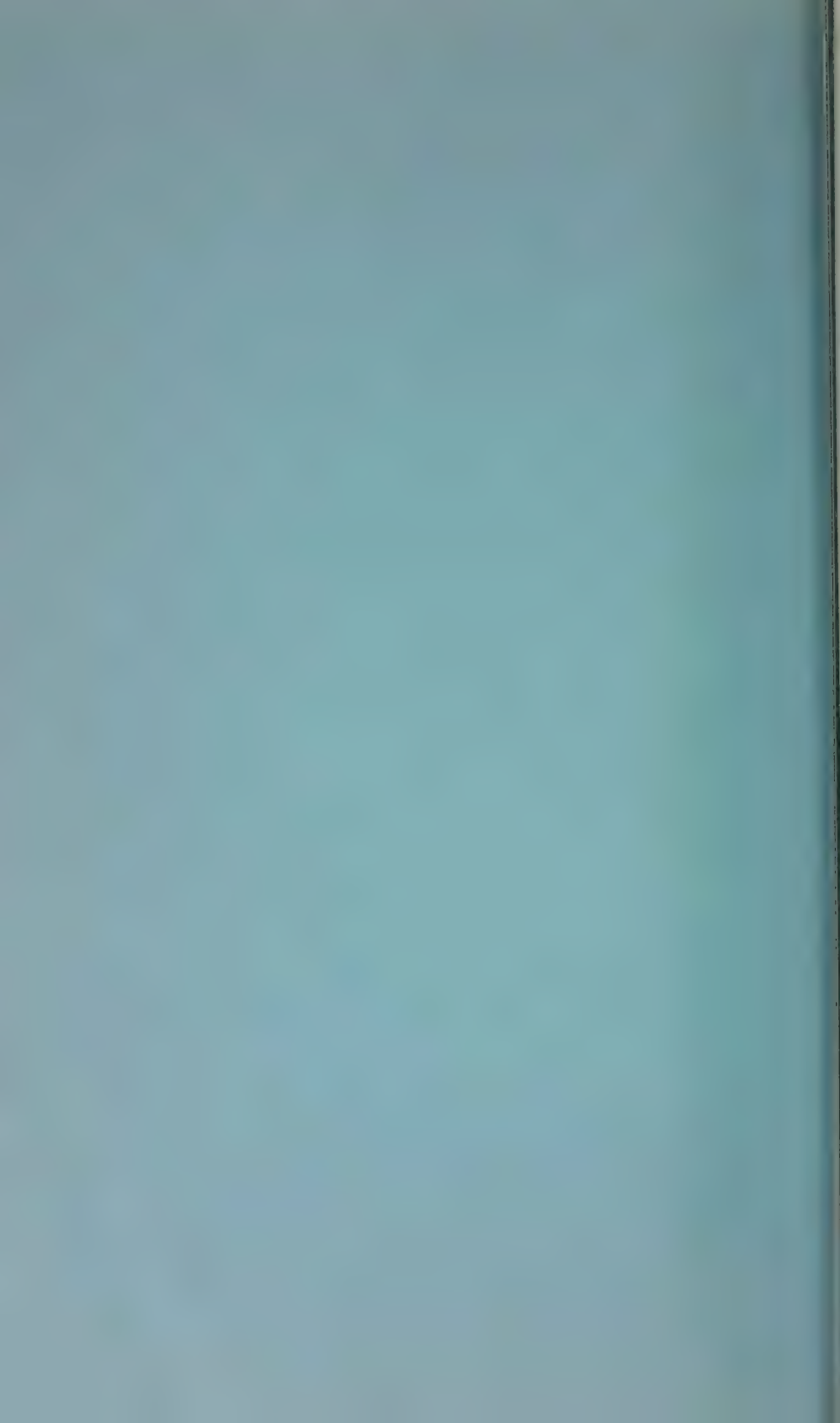
Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those Rules.

JAMES J. ARDITTO,
Attorney for Appellant.







APPENDIX.

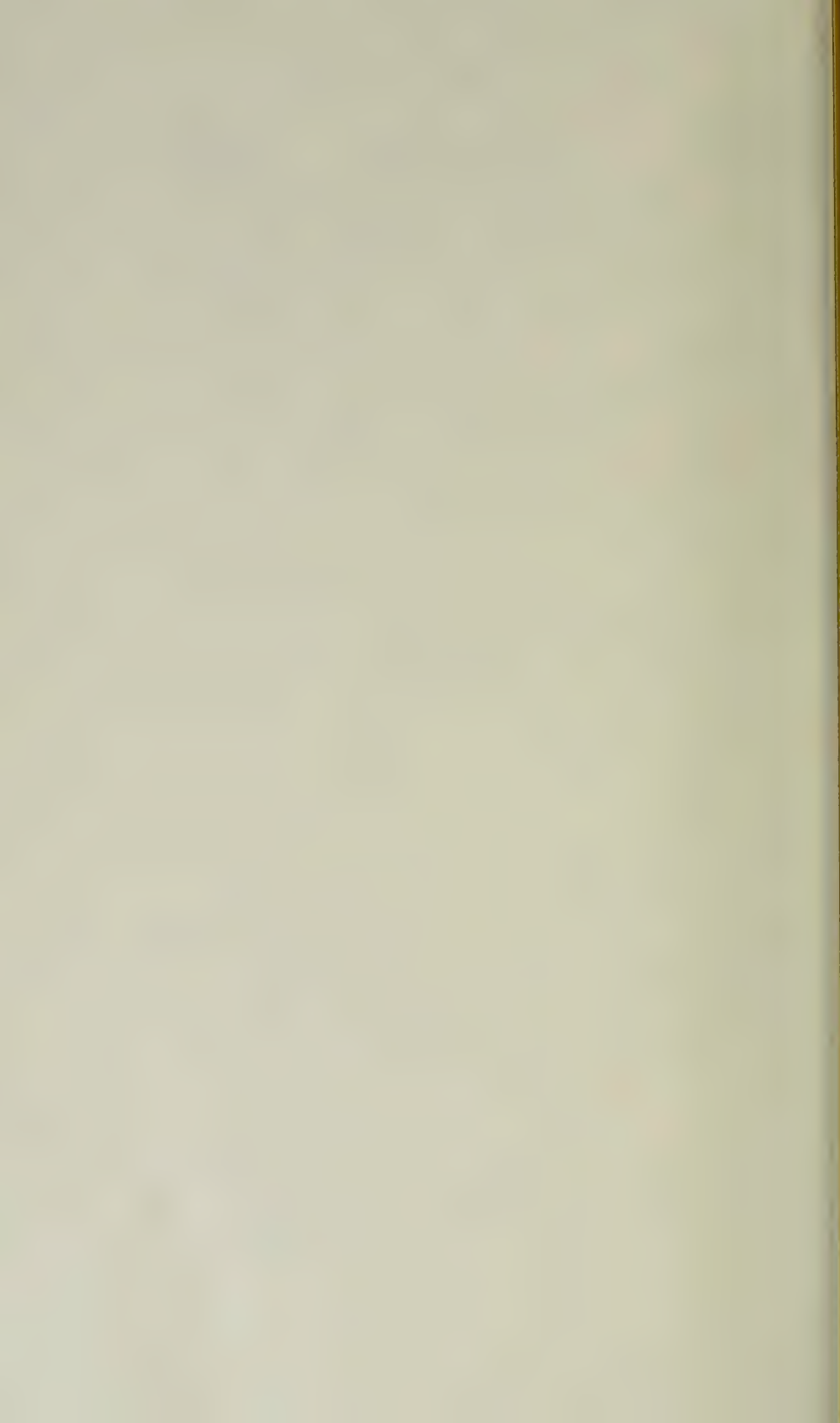
List of Exhibits* as Required by Rule 18(f).

<u>Exhibit No.</u>	<u>Description</u>	<u>Source of Exhibit</u>
1	\$42,000.00 check (used to pay for inventory)	Exh. M, p. 61 & Rep. Tr. p. 36
2	\$60,000.00 check issued to Appellant	Exh. M, p. 61 & Rep. Tr. p. 36
3	Letter to Steve Dadigan	Exh. M, p. 65 & Rep. Tr. p. 36
4	Grant Deed of 2-7-61	Exh. M, p. 74 & Rep. Tr. p. 36
5	Stock book of Pomona Properties, Inc.	Exh. M, p. 120 & Rep. Tr. p. 36
6	Inventory of McDaniels Markets as of 1-29-61	Exh. M, p. 151 & Rep. Tr. p. 36
7	Inventory of Pomona Properties, Inc. as of 2-9-61	Exh. M, p. 151 & Rep. Tr. p. 36
8	Pomona Properties, Inc. Minute Book	Exh. M, p. 165 & Rep. Tr. p. 36
9	Bank statement of Jack Goldsmith in City National Bank—with attached checks	Exh. N, p. 24 & Rep. Tr. p. 36
10	Holmby-Sunset check of 1-26-61 for \$20,000.00	Exh. N, p. 27 & Rep. Tr. p. 36
11	Check of Appellant, dated November 24, 1959, for \$5,000.00 and check for \$3,000.00 dated November 30, 1959	Exh. N, p. 37 & Rep. Tr. p. 36
12	Bank statements and cancelled checks of Jack Goldsmith (d/b/a Santa Ana Properties)	Exh. N, p. 41 & Rep. Tr. p. 36
13	Seven checks for \$2,000.00	Rep. Tr. p. 228
14	Four cashier's checks (totaling \$8,000.00), together with deposit slip and bank statement	Rep. Tr. p. 229
15	Jack Goldsmith's bank ledger sheet	Rep. Tr. p. 232
16	Cashier's check—Southwest Bank—for \$20,000.00 dated 1-30-61	Rep. Tr. p. 234
17	Letter of 2-10-61 from Steve Dadigan	Rep. Tr. p. 244

*Creditors' (or Appellant's) exhibits are "numerals" and Trustee's Exhibits are "letters of the alphabet".

<u>Exhibit No.</u>	<u>Description</u>	<u>Source of Exhibit</u>
18	Petition of 4-10-61 (by reference) for authority to confirm sale	Rep. Tr. p. 312
19	Supplemental petition to confirm sale, filed 6-21-61	Rep. Tr. p. 312
20	Order confirming Trustee's sale, filed 6-21-61	Rep. Tr. p. 312
21	All creditors' claims filed with Trustee (by reference)	Rep. Tr. p. 359
A	Escrow #1929 (5 pages) — between Pomona Properties, Inc. and McDaniels Market	Exh. M, p. 33 & Rep. Tr. p. 36
B	Financial statement of Appellant—dated 1-5-61	Exh. M, p. 51 & Rep. Tr. p. 36
C	City National Bank ledger sheets (2)	Exh. M, p. 89 & Rep. Tr. p. 36
D	Pomona Properties check for \$13,287.-91 (payable to McDaniels Market)	Exh. M, p. 93 & Rep. Tr. p. 36
E	Grant Deed to Santa Ana Apartments from Corenson to Vinemore Company	Exh. M, p. 96 & Rep. Tr. p. 36
F	Check No. 1060 for \$1,000.00	Exh. M, p. 114 & Rep. Tr. p. 36
G	Check for \$10,000.00	Exh. M, p. 117 & Rep. Tr. p. 36
H	Check for \$10,000.00	Exh. M, p. 117 & Rep. Tr. p. 36
I	Jack Goldsmith report on Bankrupt	Exh. M, p. 161 & Rep. Tr. p. 36
J	List of creditors filed April 13, 1961 (by Jack Goldsmith)—by reference	Exh. M, p. 163 & Rep. Tr. p. 36
K	Letter dated November 2, 1961, to Jack Goldsmith	Exh. N, p. 15 & Rep. Tr. p. 36
L	Schedules A and B and Statement of Affairs—by reference	Exh. N, p. 60 & Rep. Tr. p. 36
M	Transcript of hearings on February 6 and March 1, 1962, re objections to claims of Appellant—by reference	Rep. Tr. p. 39
N	Transcript of hearings of May 7 and May 8, 1962, on objections to claims of Appellant—by reference	Rep. Tr. p. 39
O	Findings of Fact and Conclusions of Law dated 7-26-62—by reference	Rep. Tr. p. 39
P	Order dated July 26, 1962 (re claims of Appellant)	Rep. Tr. p. 39

<u>Exhibit No.</u>	<u>Description</u>	<u>Source of Exhibit</u>
Q	Record of sales of bankrupt	Rep. Tr. p. 152
R	Daily record of Pomona Properties, Inc. through 2-25-61	Rep. Tr. p. 162
S	Report, dated 10-17-63, of Accountant (M. T. Mulherin)	Rep. Tr. p. 168
T	Southwest Bank check book of Bankrupt	Rep. Tr. p. 181
U	Bank statements of Bankrupt (Southwest Bank)—5 pages	Rep. Tr. p. 181
V	Checks on Southwest Bank by Bankrupt, deposit receipts and signature card	Rep. Tr. p. 181
W	Bankrupt's bank book from Southwest Bank	Rep. Tr. p. 182
X	Bankrupt's bank book on City National Bank	Rep. Tr. p. 183
Y	3 ledger sheets—of Bankrupt—from City National Bank	Rep. Tr. p. 183
Z	12 pages of City National Bank statements (Jack Goldsmith account)	Rep. Tr. p. 184
AA	Checks drawn on City National Bank	Rep. Tr. p. 185
BB	City National Bank checks drawn on Bankrupt's account	Rep. Tr. p. 185
CC	Miscellaneous bank records of Bankrupt	Rep. Tr. p. 186
DD	Bank book—of Bankrupt—from City National Bank	Rep. Tr. p. 186
EE	Letter from McDaniel's Markets re Escrow #1929	Rep. Tr. p. 202
FF	March 6, 1961, inventory of Bankrupt	Rep. Tr. p. 206
GG (1-6)	6 documents pertaining to sale of Santa Ana apartments by holder of first deed of trust	Rep. Tr. p. 260
HH	Summary of testimony of Accountant Mulherin	Rep. Tr. p. 329



No. 20415

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, Trustee of the Estate of Pomona Properties, Inc., doing business as STEVE'S RANCH MARKET, Bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

APPELLEE'S BRIEF.

FILED

MAR 30 1966

WM. B. LUCK, CLERK

BUCHALTER, NEMER, FIELDS &
SAVITCH,

By BENJAMIN E. KING,
ROBERT H. THAU,

629 South Hill Street,
Fifth Floor,

Los Angeles, Calif. 90014,

Attorneys for Appellee, San Jonas, Trustec.

TOPICAL INDEX

	Page
Jurisdiction	1
Preliminary statement	4
Statement of the facts	5
Loans to bankrupt	6
A. \$42,000.00	6
B. \$60,000.00	7
C. \$20,000.00	8
Appellant's withdrawal of \$28,000.00 to prevent an attachment	9
Collection by Appellant of rents from the Santa Ana apartments after bankruptcy	10
Claims filed by Appellant in bankruptcy proceedings	11
Evidence of insolvency	11
(a) Thomas M. Mulherin	11
(b) Clyde B. White	13
(c) Sam Jonas	13
(d) Naum Tabachnick	13
(e) Ardell Welchance	14
(d) Records and documents pertaining to bankrupt's operation	14
Issues presented	15
Argument	16

I.

Court correctly determined that Appellant wrongfully appropriated \$5,400.00 in rents and is not entitled to any offset in addition to the \$1,400.00 allowed	16
---	----

ii.

II.

Page

Appellant's withdrawal of \$20,000.00 constituted
a constructive fraud on creditors 21

(1) Appellant abused his fiduciary position by
obtaining funds from an insolvent corpora-
tion to the detriment of other creditors 21

(2) The evidence clearly establishes that bank-
rupt was insolvent on February 8, 1961
and February 20, 1961 28

III.

Appellee is entitled to recover \$28,000.00 wrong-
fully appropriated by Appellant in violation of
the California Uniform Fraudulent Convey-
ance Act 42

IV.

Order allowing Appellant to file general claim if
\$20,000.00 was paid within thirty days was
proper 48

Conclusion 50

TABLE OF AUTHORITIES CITED

Cases	Page
Alpha Hardware & Supply Company v. Ruby Mines Company, 97 Cal. App. 508	43
Arbuckle, Estate of, 98 Cal. App. 2d 546	22
Avant v. United States, 165 F. Supp. 802	19
Bank of America v. Erickson, 117 F. 2d 796	38
Bank of America etc. Association v. Pendergrass, 4 Cal. 2d 258	40
Bank of Visalia v. Smith, 146 Cal. 398	39
Bonney v. Tilley, 109 Cal. 346	23, 24, 26
Boyum v. Johnson, 127 F. 2d 491	38
Century Furniture Co. v. Bernhard's, Inc., 82 F. 2d 706	48
Costello v. Fazio, 256 F. 2d 903	38
County of Los Angeles v. Faus, 48 Cal. 2d 672	34
Cumberland Glass Manufacturing Company v. De- Witt, 237 U.S. 447, 59 L. Ed. 1042	20
Efron v. Kalmanovitz, 226 Cal. App. 2d 546	22
Great Western Biscuit Company, In re, 85 F. Supp. 314	35
Hanson v. Choynski, 180 Cal. 275	26
Hassan v. Middlesex County National Bank, 333 F. 2d 838	28
Healy v. Wehrung, 229 Fed. 686	35
Heim v. Jobes, 14 F. 2d 29	25
Hickson v. Thielman, 147 Cal. App. 2d 11	46
Jones v. Nicholl, 82 Cal. 32	40, 45

	Page
Lang v. Lang, 182 Cal. 765	39
Langham, Langston & Burnett v. Blanchard, 246 F. 2d 529	35
Liquimatic Systems, Inc., In re, 194 F. Supp. 625 ..	43
Maguire v. Corbett, 119 Cal. App. 2d 244	43
McCollum v. Hamilton National Bank, 303 U.S. 245, 82 L. Ed. 819	19
Miller v. United States, 125 F. 2d 75	34
Mizell v. Phillips, 240 F. 2d 738	35
Nixon v. Goodwin, 3 Cal. App. 358	26
O'Neil v. Magner, 81 Cal. 631	40, 45
Patterson v. Missler, 238 A.C.A. 877	45
Pepper v. Litton, 308 U.S. 295, 84 L. Ed. 281	22
Rosenberg v. Semple, 257 Fed. 72	28
Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 85 L. Ed. 1293	20
Sherk, In re, 107 Fed. Supp. 144	49
Sidebotham v. Robinson, 216 F. 2d 916	39
Title Insurance and Trust Company v. California Development Company, 171 Cal. 173	24, 25, 26
Walkerly, Estate of, 108 Cal. 627	18

Statutes

Bankruptcy Act, Sec. 1(10)	1
Bankruptcy Act, Sec. 2	1
Bankruptcy Act, Sec. 24	3
Bankruptcy Act, Sec. 57g	18, 49

	Page
Bankruptcy Act, Sec. 57n	27, 48
Bankruptcy Act, Sec. 60a(1)	18, 20
Bankruptcy Act, Sec. 67d	44
Bankruptcy Act, Sec. 68	19
Bankruptcy Act, Sec. 68(a)	19, 20
Bankruptcy Act, Sec. 68b	18
Bankruptcy Act, Sec. 70a	16
Bankruptcy Act, Sec. 70a(4)	21
Bankruptcy Act, Sec. 70e(1)	21
Civil Code, Sec. 3439.02(a)	44
Civil Code, Sec. 3439.03	43
Civil Code, Sec. 3439.04	43
Civil Code, Sec. 3439.05	46
Civil Code, Sec. 3439.06	46
Civil Code, Sec. 3439.07	42
Civil Code, Sec. 3517	32
United States Code, Title 11, Sec. 1	1
United States Code, Title 11, Sec. 1(10)	1
United States Code, Title 11, Sec. 11	1
United States Code, Title 11, Sec. 47	3
United States Code, Title 11, Sec. 91n	27, 48
United States Code, Title 11, Sec. 93g	18, 49
United States Code, Title 11, Sec. 96a(1)	18, 20
United States Code, Title 11, Sec. 107d	44
United States Code, Title 11, Sec. 108	19
United States Code, Title 11, Sec. 108b	18

	Page
United States Code, Title 11, Sec. 110a	16
United States Code, Title 11, Sec. 110a(4)	21
United States Code, Title 11, Sec. 110e(1)	21

Textbooks

4 Collier on Bankruptcy (14th Ed.), Sec. 68.02, p. 711	20
Cowans, Bankruptcy Law and Practice, Sec. 345, p. 184	49

No. 20415
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, Trustee of the Estate of Pomona Properties, Inc., doing business as STEVE'S RANCH MARKET, Bankrupt,

Appellee.

Appeal From the United States District Court for the
Southern District of California, Central Division.

APPELLEE'S BRIEF.

Jurisdiction.

The United States District Court, Southern District of California, Central Division, is a Court of Bankruptcy, and is vested with original jurisdiction in proceedings under the Bankruptcy Act. (Bankruptcy Act, Sections 1 (10), 2; 11 U.S.C. Sections 1, 1 (10), 11.)

An Involuntary Petition in bankruptcy was filed in the above-mentioned Bankruptcy Court against Pomona Properties, Inc., dba Steve's Ranch Market [Clk. Tr. pp. 2-8], and on April 5, 1961, the bankrupt was so adjudicated. [Clk. Tr. p. 77.]

On June 27, 1961, Appellant, E. E. Hassen, filed Claim No. 101 in the sum of \$120,000.00 (later reduced to \$60,000.00) in such bankruptcy proceedings [Clk. Tr. pp. 26-27.] On July 13, 1961, Appellant, as President of Holmby-Sunset Corp., a California corporation, also filed Claim No. 105 therein in the sum of \$42,000.00. [Clk. Tr. pp. 26-27.] On July 20, 1962, Findings of Fact and Conclusions of Law were filed sustaining the objections of Sam Jonas, Trustee therein, by allowing said claims, payment of which, however, was to be subordinated to the prior payment of the allowed claims of other general unsecured creditors. [Clk. Tr. pp. 26-31.] An order to this effect was thereafter filed on July 26, 1962. [Clk. Tr. pp. 32-33.]

On April 19, 1963, Appellee, Sam Jonas, as Trustee, filed with the Bankruptcy Court an Application for Order Requiring Return of Converted Assets and to Set Aside Preferences and Fraudulent Conveyances [Clk. Tr. pp. 34-39] and an Order to Show Cause Re Application for Order Requiring Return of Converted Assets and to Set Aside Preferences and Fraudulent Conveyances. [Clk. Tr. pp. 40-41.] Appellant answered said Application on May 13, 1963. [Clk. Tr. pp. 42-47.]

On September 11, 1963, Appellee filed an Amended Application for Order Requiring Return of Converted Assets and to Set Aside Preferences and Fraudulent Conveyances. [Clk. Tr. pp. 57-62.] On September 11, 1963, Appellant filed an Answer to this Amended Application. [Clk. Tr. pp. 63-68.]

At the conclusion of the hearings, on December 11, 1964, the Referee signed and filed Findings of Fact and Conclusions of Law that Appellee was entitled to re-

cover the sum of \$52,500.00. [Clk. Tr. pp. 76-90.] Appellant had filed objections to said Findings of Fact and Conclusions of Law. [Clk. Tr. pp. 91-98.] On December 11, 1964, an Order Requiring Return of Converted Assets and Setting Aside Preferences and Fraudulent Conveyances was filed and signed by the Referee. [Clk. Tr. pp. 99-101.]

On December 21, 1964, Appellant filed a Petition for Review with the District Court [Clk. Tr. pp. 102-112], and on February 12, 1965, the Referee signed and filed his Certificate on Application for Review of Order of December 11, 1964. [Clk. Tr. pp. 113-123.]

On June 29, 1965, a hearing was held before the Honorable William M. Byrne, presiding Judge of the United States District Court for the Southern District of California, Central Division, on the Petition of Appellant for Review of the Referee's Order of December 11, 1964. On July 9, 1965, Judge Byrne affirmed and approved the Referee's Order in all respects except the amount recovered by the Appellee was modified from \$52,500.00 to \$52,000.00, and it was provided that if Appellant paid \$20,000.00 in partial satisfaction of the Order within thirty (30) days after the rendition thereof he could file a general unsecured claim in the bankruptcy proceeding within thirty (30) days after making payment. Said Order was entered on July 12, 1965. [Clk. Tr. pp. 124-126.]

On July 16, 1965, Appellant filed a Notice of Appeal from the Order of the United States District Court entered on July 12, 1965. [Clk. Tr. p. 127.]

This Court has jurisdiction to determine this appeal pursuant to Bankruptcy Act, Section 24. (11 U.S.C. Section 47.)

Preliminary Statement.

In December, 1960, Appellant, Erwin E. Hassen, and Steve Dadigan arranged for Pomona Properties, Inc., dba Steve's Ranch Market, the bankrupt herein, a purported corporation dominated and controlled by Appellant, to acquire the assets of a market. Bankrupt corporation had only \$100.00 in paid-in capital so Appellant loaned bankrupt \$20,000.00 and in return received two \$10,000.00 post-dated checks, which he cashed on February 8, 1961, and February 20, 1961, respectively, at which times the bankrupt was insolvent.

Appellant also caused the alleged equity in certain heavily encumbered apartment buildings in Santa Ana to be transferred to the bankrupt in exchange for a \$60,000.00 note. Appellee, Sam Jonas, Trustee in Bankruptcy, submits this property was worthless insofar as the bankrupt was concerned.

Bankrupt began operating the market on January 30, 1961. Some two weeks later, Steve Dadigan terminated his association with the bankrupt. To prevent an attachment either by Dadigan or another creditor, Appellant on February 20, 1961, withdrew \$28,000.00 from the bankrupt's till and bank accounts.

On February 24, 1961, a keeper was placed on bankrupt's premises. On March 1, 1961, an Involuntary Petition in Bankruptcy was filed against Pomona Properties, Inc., and on April 5, 1961, bankrupt was so adjudicated.

Subsequent to the date of adjudication, Appellant collected \$5,400.00 in rents accruing from the Santa Ana apartment house property, which had previously been transferred to bankrupt.

After extensive hearings, the Referee ruled that Appellant must return:

1. \$4,500.00 in rents wrongfully appropriated, allowing a \$900.00 offset.
2. \$20,000.00 which he, as a fiduciary, received from the insolvent corporation to the detriment of other creditors.
3. \$28,000.00 appropriated from the insolvent corporation in violation of the California Uniform Fraudulent Conveyance Act. Paying back this money to certain creditors of bankrupt, but not to the Trustee, was held not to entitle Appellant to an offset.

The Referee's Order was affirmed by Judge Byrne, on July 12, 1965, excepting that the liability for converting the rents was reduced to \$4,000.00 resulting in a judgment for Appellee in the total sum of \$52,000.00; it was also provided that if Appellant returned \$20,000.00 within thirty days of Judgment, he could file a claim as a general creditor.

Appellant then perfected this appeal.

Statement of the Facts.

In December, 1960, Appellant, E. E. Hassen, and Steve Dadigan acquired Pomona Properties, Inc., the bankrupt herein, and arranged for it to purchase the assets of McDaniel's Market in Inglewood, California.

[Ex. M pp. 26-28.] Appellant had learned that this market was losing \$10,000.00 or \$15,000.00 a month, and the McDaniels' concern wanted to dispose of it. [Ex. M pp. 22-23.]

At a meeting in December of 1960, regarding the acquisition of the market, Appellant said to Steve Dadigan:

"I will not put any money into it, but I will do the following: There is a corporation I am interested in that might be interested in making a deal whereby you and I will own all the stock and then whatever we put in we will loan to the corporation." [Ex. M p. 24.]

Loans to Bankrupt.

A. \$42,000.00

On November 24, 1959, Vinemore Company acquired by grant deed from Richard Corenson and Donna Corenson six parcels of property situated in Santa Ana, each improved with an apartment building. [Ex M p. 96.] The stock of Vinemore Company, a California corporation, was held by Appellant's wife and daughters, and the Appellant was President. [Ex. M p. 100.]The equity in the Santa Ana property was purchased for \$41,000.00 [Ex. M p. 97] subject to first Trust Deeds in the principal amount of \$150,000.00. [Ex. GG.] Vinemore Company apparently either paid \$5,000.00 down and the balance of \$36,000.00 was later paid by Holmby-Sunset Corp. or Appellant [Ex. M pp. 100, 132 133], or possibly Appellant paid the \$5,000.00 down and Vinemore Company merely held the Grant Deed for him. [Ex. M p. 101.] Sometimes in either the mid-

dle or third quarter of 1960, a note for \$42,000.00 secured by six Deeds of Trust in the amount of \$7,000.00 each on these Santa Ana apartment buildings was transferred by Vinemore Company to Holmby-Sunset Corp. [Ex. M p. 107] without any consideration passing between them. [Ex. M p. 110.] Holmby-Sunset Corp. is a purported corporation of which Appellant was President and his two children the stockholders. [Ex. M p. 26.] (Appellant, however, was never able to find the books and records of such company.) [Ex. N p. 38.]

Appellant arranged for Holmby-Sunset Corp. to transfer to bankrupt this \$42,000.00 note secured by the Deeds of Trust [Ex. M pp. 31-32], and in return, bankrupt issued a note for \$42,000.00 to Holmby-Sunset Corp. [Ex. 1; Ex. M pp. 61-62, 70-72.] On December 20, 1960, an escrow was opened wherein the bankrupt turned over to McDaniel's Market the Note and Trust Deeds received from Holmby-Sunset Corp. in exchange for certain wholesale inventory. [Ex. M pp. 30-33.]

B. \$60,000.00

Sometime in January of 1961, Appellant arranged to transfer to bankrupt the above mentioned six apartment buildings in Santa Ana [Ex. M pp. 18-19] which he claimed were being held in trust for him by Vinemore Company. [Ex. M p. 17.] These buildings were subject to First Trust Deeds in the amount of \$150,000.00 [Ex. GG] and Second Trust Deeds in the total amount of \$42,000.00. [Ex. M p. 107.] At one point, Appellant testified that "if you could keep the operated

rental on a full rental basis, I think it would be worth maybe \$5,000.00, \$6,000.00," [Rep. Tr. p. 316], which would be a total of \$30,000.00 to \$36,000.00 for the six parcels. Appellant received a note for \$6,000.00 from bankrupt in exchange for the alleged equity in such property. [Ex. 1; Ex. M pp. 15-20.]

On December 15, 1961, the Santa Ana apartments were sold by the holder of the First Trust Deed, pursuant to a Notice of Breach and Default and of election to cause sale under Deed of Trust, dated May 16, 1961, and recorded in the official records of Orange County on May 19, 1961. [Rep. Tr. pp. 257-261; Ex. GG.] Such sale produced no proceeds in excess of the amount of the First Deeds of Trust, and the holder thereof became the owner of the property. [Ex. GG.]

C. \$20,000.00

In addition to the inventory and the offsetting payables, the alleged equity in the Santa Ana apartments, and the offsetting \$60,000.00 note, there was \$100.00 paid-in capital as reflected by the Minute Book of Pomona Properties, Inc. [Ex. M p. 165; Rep. Tr. p. 36; Ex. S p. 1.] Any other advances by Appellant to bankrupt were treated as loans. [Ex. M pp. 34-35, 37, 43, 82-83, 73-75, 78, 81.] Neither Mr. Goldsmith nor Mr. Dadigan or anybody else contributed money or other assets to Pomona Properties, Inc. [Ex. N pp. 29-30.] Thus, bankrupt began operation of the market with \$42,000.00 in wholesale inventory, an offsetting payable of \$42,000.00 owed to Holmby-Sunset Corp., an alleged equity in the apartments in Santa Ana, a note payable of \$60,000.00, and paid-in capital of \$100.00.

This dearth of working capital necessitated Appellant loaning bankrupt \$20,000.00 on or about January 26,

Appellant took two post-dated checks from bankrupt, each in the amount of \$10,000.00, one February 4, 1961, and the other February 13, 1961. These checks were cashed by Appellant and cleared the bank on February 8, 1961, and February 20, 1961, respectively. [Ex. M pp. 116-118.]

**Appellant's Withdrawal of \$28,000.00 to
Prevent an Attachment.**

The market opened for business on January 30, 1961. [Ex. M p. 69.] Some three weeks later, financial problems and internal dissension arose and Steve Dadigan ceased his association with Appellant and bankrupt. [Ex. M pp. 41-43, 130-131.] Steve Dadigan claims he left bankrupt after one week of operation. [Rep. Tr. pp. 54-55.]

On February 20, 1961, Appellant withdrew at least \$28,000.00 belonging to bankrupt. [Ex. M pp. 44-45, 76-88.] Some of this \$28,000.00 was in the form of cash taken from the market and some was withdrawn from a bank account. [Ex. M pp. 76-77.] Appellant did not know how much cash he withdrew from bankrupt [Ex. M pp. 86-87], but contends that the total sum of cash and checks was \$28,000.00. However, T. M. Mulherin, a Certified Public Accountant, who was engaged as an independent expert by the Appellee, testified that there was an additional amount of \$17,688.21 in unaccounted for cash withdrawals. [Rep. Tr. pp. 325-329; Ex. HH.]

Appellant testified that he withdrew the \$28,000.00 pursuant to a telephone call from the store manager who said "I hear somebody is going to attach. I think Dadigan is going to make an attachment." [Ex. M pp. 1961. [Ex. N pp. 24-29.] In exchange for this loan,

43-44, 76, 77-88.] Additionally, there is evidence that Orange Empire, to whom bankrupt owed approximately \$29,000.00, was trying to collect. [Rep. Tr. p. 73.] In fact, on February 24, 1961, just four days after Appellant withdrew \$28,000.00, allegedly to prevent an attachment by Steve Dadigan, a creditors' committee composed of Foremost Dairy, Arden Farms and Orange Empire, installed a keeper in the market. [Ex. M p. 129; Rep. Tr. pp. 114-117.]

**Collection by Appellant of Rents From the
Santa Ana Apartments After Bankruptcy.**

On March 1, 1961, an Involuntary Petition in Bankruptcy was filed against bankrupt and Sam Jonas was appointed Receiver. [Clk. Tr. pp. 2-8; Rep. Tr. p. 108.]

On April 5, 1961, the bankrupt was so adjudicated and Sam Jonas became Trustee of the estate on April 21, 1961.

Between May 10, 1961 and June 15, 1961, after bankrupt was so adjudicated and the Trustee appointed, Appellant collected \$5,400.00 in rents from the Santa Ana apartments [Clk. Tr. p. 85, lines 20-27], which had previously been transferred to bankrupt. [Clk. Tr. p. 78.] While Appellant admits collecting these rents, he claims an offset for certain amounts allegedly paid to pre-bankruptcy creditors of bankrupt. [Ex. N pp. 8-15, 17-24; Rep. Tr. pp. 6-24.]

Claims Filed by Appellant in Bankruptcy Proceedings.

On June 27, 1961, Appellant filed Claim No. 101 in the bankruptcy proceedings for \$120,000.00 [Clk. Tr. p. 27, para. III] and on July 13, 1961, Appellant's *alter ego*, Holmby-Sunset Corp. [Clk. Tr. p. 28, para. VI] filed Claim No. 105 for \$42,000.00. [Clk. Tr. p. 27, para. IV.] Appellant waived in open Court his right to \$60,000.00 of the original \$120,000.00 claim. [Ex. M pp. 3-5.]

The \$42,000.00 Claim No. 105 of Holmby-Sunset Corp. was based on the note executed on January 11, 1961, by Pomona Properties, Inc., by Jack Goldsmith, President. [Ex. M p. 7.] After hearing the testimony which has been transcribed as Exhibits M and N herein, the Referee denied such claims in the amount of \$60,000.00 and \$42,000.00 as general unsecured claims on a par with other creditors. However, the Referee allowed these claims as subordinated to the general unsecured creditors. [Clk. Tr. p. 31, para. I and II.]

Evidence of Insolvency.

(a) Thomas M. Mulherin.

On April 19, 1963, the Trustee filed an Application for an Order Requiring Return of Converted Assets, and to Set Aside Preferences and Fraudulent Conveyances. At the hearings on this application, Thomas M. Mulherin, a Certified Public Accountant, who graduated in 1929 with an Accounting Degree, worked as a special agent for the Federal Bureau of Investigation

from 1929 until 1953 and has been a Certified Public Accountant of California since 1946 [Rep. Tr. pp. 60-61], testified regarding the bankrupt's financial condition. Mr. Mulherin made a meticulous search for all possible records of bankrupt. To supplement the records he found, Mr. Mulherin interviewed the Certified Public Accountant who was supposed to have set up the records and worked on them [Rep. Tr. p. 63]; searched the files of the Trustee and the attorney for the Trustee [Rep. Tr. p. 63]; examined the claims filed in the Bankruptcy Court [Rep. Tr. p. 63]; reviewed all the exhibits and testimony reflecting previous Bankruptcy Court proceedings in this matter [Rep. Tr. pp. 63-64]; and, interviewed Clyde White, a former manager of bankrupt [Rep. Tr. p. 64], Steve Dadigan and Sam Jonas, the Trustee. [Rep. Tr. p. 64.]

Based on the above investigation, Mr. Mulherin concluded that on February 4, 1961, there was capital impairment or insolvency in the amount of \$52,114.00 [Ex. S p. 4; Rep. Tr. pp. 165-171]; on February 13, 1961, there was capital impairment or insolvency in the amount of \$47,857.00 [Ex. S p. 4; Rep. Tr. pp. 165-171]; and on February 20, 1961, in the amount of \$46,177.00. [Ex. S p. 4; Rep. Tr. pp. 165-171.]

Also between January 30, 1961, the day the market opened, and February 24, 1961, the day the keeper was installed, bankrupt incurred debts of some \$69,633.00, as indicated by the claims filed in the estate and allowed [Ex. J; Ex. M p. 163; Rep. Tr. p. 36; Ex. L; Ex. N p. 60; Rep. Tr. pp. 39-40], and as of February 20, 1961, earned a maximum gross profit of only \$21,579.00. [Ex. S pp. 2-4.]

(b) Clyde B. White.

Clyde B. White, former manager of bankrupt's food department [Rep. Tr. pp. 71-72], and connected with the grocery business since 1935 [Rep. Tr. pp. 84-85], testified regarding the average retail markup of bankrupt in February, 1961 [Rep. Tr. pp. 88-92], and that he observed Mr. Jonas search bankrupt's office for records, and find three or four sheets of paper but no ledgers. [Rep. Tr. p. 77.]

(c) Sam Jonas.

Sam Jonas, Trustee, testified that immediately upon being appointed Receiver on March 1, 1961, he went to the office of bankrupt to gather whatever books or records he could find. [Rep. Tr. p. 108.] Mr. Jonas found none of the standard set of records usually kept in a normal business operation, excepting only some checks, some schedules of cash sales, three or four loose ledger sheets and a number of invoices. [Rep. Tr. pp. 108-109]. Exhibit Q, a record of gross receipts contained four ledger sheets, and Exhibit R, a daily record of sales to February 25, 1961, were identified by Mr. Jonas as documents he found at bankrupt's office. [Rep. Tr. pp. 109, 111-112].

Subsequently, Mr. Jonas received some checks and checkbooks, but despite requests to Appellant and Mr. Goldsmith for other books and records of bankrupt, Mr. Jonas never received any. [Rep. Tr. pp. 113-114.]

(d) Naum Tabachnick.

Naum Tabachnick, a Certified Public Accountant, testified that the partnership of Silpa & Tabachnick was retained as accountants by bankrupt; [Rep. Tr. pp. 126-128] but that he never set up an actual gen-

eral ledger, nor did he set up a journal book for cash disbursements, other than those sheets identified as Exhibit Q. [Rep. Tr. pp. 129-130.]

(e) Ardell Welchance.

Ardell Welchance testified [Rep. Tr. p. 262] his duties for bankrupt consisted of cashing checks, selling money orders and paying utility bills, verifying checkers' tills when they were turned in, calculating the deposits from the departments and keeping the departmental totals in a ledger. [Rep. Tr. p. 268.] Mr. Welchance identified the four yellow pages of Exhibit Q [Rep. Tr. p. 269] and certain pages in Exhibit R as being in his handwriting.. [Rep. Tr. pp. 277-280.]

**(f) Records and Documents Pertaining to
Bankrupt's Operation.**

In addition to the above mentioned testimony, Appellee introduced all of the records and documents pertaining to bankrupt's operation that could be found.¹

¹The following Exhibits, among others, were introduced into evidence: Bankrupt's checkbook from Southwest Bank—Exhibit T; five yellow pages consisting of the bank statements of the bankrupt issued by Southwest Bank—Exhibit U; checks drawn by bankrupt upon Southwest Bank, deposit receipts, Exhibit W [Rep. Tr. p. 182]; checkbook for bankrupt at City National Bank in Beverly Hills, check stubs as well as unused checks—Exhibit X [Rep. Tr. pp. 182-183]; bank statements for bankrupt from the City National Bank—Exhibit Y [Rep. Tr. p. 183]; twelve pages of bank statements reflecting the account of Jack Goldsmith at City National Bank—Exhibit Z [Rep. Tr. p. 184]; checks drawn on Goldsmith's account at City National Bank—Exhibit AA [Rep. Tr. p. 185]; checks drawn on bankrupt's account at City National Bank—Exhibit BB [Rep. Tr. p. 185]; miscellaneous bank records (deposit receipts, various notification slips, service charges) Exhibit CC [Rep. Tr. p. 186]; bank book of Pomona Properties Commercial Account at City National Bank—Exhibit DD [Rep. Tr. p. 186]; letter dated February 14, 1961 from McDaniel's Mkt. re escrow 1929—Exhibit EE [Rep. Tr. p. 202]; inventory of the stock and trade at bankrupt's premises

Issues Presented.

1. Is Appellant, who was held liable for wrongfully converting \$4,000.00 in rents belonging to the Trustee in Bankruptcy, entitled to setoff payments made by him, not to the Trustee, but to pre-bankruptcy creditors of the bankrupt?

2. Did Appellant commit a constructive fraud on creditors by using his fiduciary position to obtain funds from an insolvent corporation to pay a \$20,000.00 debt to himself, thereby diminishing the assets available to other unsecured creditors?

3. Did Appellant violate the California Uniform Fraudulent Conveyance Act by removing \$28,000.00 from an insolvent corporation to avoid an attachment, and is Appellant entitled to a credit by reason of allegedly returning such sum to certain pre-bankruptcy creditors, but not to the Trustee.

4. Was it error to require Appellant to pay \$20,000.00 to the Trustee within thirty days to qualify for filing a general claim in such amount.

taken by Joseph J. Muscolino & Associates on March 6, 1961—Exhibit FF [Rep. Tr. p. 206] ; six documents, each covering the separate parcels reflecting the Trustee's sale of the Santa Ana apartment properties of December 15, 1961—Exhibit GG [Rep. Tr. p. 260] ; Summary of the testimony of Mr. Mulherin relating to unexplained cash withdrawals from bankrupt—Exhibit HH [Rep. Tr. p. 329].

ARGUMENT.

I.

Court Correctly Determined That Appellant Wrongfully Appropriated \$5,400.00 in Rents and Is Not Entitled to Any Offset in Addition to the \$1,400.00 Allowed.

The evidence is undisputed that Appellant wrongfully converted \$5,400.00 in rents which clearly belonged to the bankrupt estate. Appellant does not deny such misappropriation but claims an offset. (App. Op. Br. pp. 9-10, 22-24.)

Specifically, between May 10, 1961 and June 15, 1961, Appellant collected (App. Op. Br. pp. 9-10, 22-24) \$5,400.00 in rents from the Santa Ana apartments. [Clk. Tr. p. 85, lines 20-27; App. Op. Br. pp. 9, 23.] These apartments had been transferred to the bankrupt on February 7, 1961. [Clk. Tr. p. 78, para. V.] On April 5, 1961, the bankrupt was so adjudicated. Sam Jonas had been appointed Receiver on March 1, 1961, and subsequently, on April 21, 1961, was appointed and still is the qualified and acting Trustee. [Clk. Tr. p. 77; Rep. Tr. pp. 107-108.] As such Receiver and Trustee, Appellant succeeded to all the assets of the bankrupt and was entitled to all rents, issues and profits arising therefrom. *Bankruptcy Act*, Section 70a, 11 U.S.C. Section 110a.

While Appellant admits appropriating these rents, he claims an offset of \$5,599.95, for sums allegedly used to pay utility bills for bankrupt's customers, and as such claimed by him to be funds held in trust. (App. Op. Br. pp. 9-10, 22-24.) Appellant, however, received all the credit, if any, to which he is entitled as he was allowed an offset of \$900.00 by the Referee [Rep. Tr.

pp. 22-24; Clk. Tr. pp. 99-100] and an additional \$500.00 by the District Court, or a total of \$1,400.00. [Clk. Tr. pp. 124-126.]

Appellant should be granted no further offset for the following reasons:

1. The evidence upon which Appellant bases his claim of offset is vague and unsupported, both as to the source and the use of the funds. Only the self-serving statements of Jack M. Goldsmith, the *alter ego* of Appellant [Clk. Tr. p. 81, lines 10-29; p. 28, lines 25-32; p. 29, lines 1-11], even remotely substantiate the claimed offset. Thus, for example, the source of the funds used to pay certain utility bills is extremely vague and the Referee was not bound to accept the evidence offered by Appellant on this point. In attempting to explain the source of certain of the funds, Mr. Goldsmith said: "That may have also come from Santa Ana, if it did not come from Dr. Hassen, that is the only place I could have gotten it." [Ex. N p. 21, lines 24-26.] Thus it is possible that some of the money allegedly used to pay customers' utility bills was additional rental money from the Santa Ana apartments above the \$5,400.00 claimed by the Trustee. Appellant, of course, cannot use funds converted by him and owed to Trustee to support his own claim of an offset.

Similarly, the asserted use of the funds to satisfy the alleged obligations of the bankrupt to various creditors is founded on the wholly unsupported testimony of Goldsmith [Ex. N p. 23], although the Court below apparently accepted this testimony and allowed a credit for \$500.00 in addition to the \$900.00 allowed by the Referee. Even if the evidence showed that the funds were used to pay certain obligations of bank-

rupt, there is no credible proof that a trust existed, either in favor of the customers from whom money was collected for payment of utility bills, or the utility companies to which this money was owed. It is true that Goldsmith made statements that the money collected by the bankrupt from its customers for utility bills and money orders was held in trust. [Ex. N p. 23.] However, these legal conclusions by Goldsmith, when weighed against the contrary evidence that the amounts collected for utility bills were not segregated but were commingled with other money of the bankrupt and placed in its general account [Rep. Tr. pp. 19-20], fail to demonstrate the existence of a trust fund.

See:

In the Matter of the Estate of Walkerly, 108 Cal. 627 (1895).

In the absence of the establishment of a trust fund for the benefit of these creditors, paying their bills to the exclusion of other creditors constituted an illegal preference. A right to an offset may not be based upon the carrying out of such a wrongful act. *Bankruptcy Act*, Section 60a (1), 11 U.S.C. Section 96a (1).

2. No portion of the money claimed as a setoff was received by the Trustee or Receiver. Appellant claims that funds constituting the alleged setoff were applied to the payment of certain pre-bankruptcy debts. (App. Op. Br. p. 23.) This, however, does not satisfy his burden of demonstrating that the funds allegedly returned reached the Trustee or benefited the Estate. *Bankruptcy Act*, Sections 68b, 57g; 11 U.S.C. Sections 108b, 93g.

3. The debt owed by Appellant to the Trustee for wrongfully appropriating rents arose after bankruptcy proceedings were initiated. Section 68(a) of the Bankruptcy Act contemplates setoffs only when "mutual debts or mutual credits" exist. Whether a setoff can be sustained in bankruptcy depends wholly upon the terms of Section 68 and not upon State law or statute.

See:

McCollum v. Hamilton National Bank, 303 U.S. 245, 82 L. Ed. 819 (1938).

The Courts have repeatedly held that the payment of claims owed by the bankrupt prior to bankruptcy cannot be setoff against sums owed to the Trustee and arising after bankruptcy, as they are not mutual debts or mutual credits.

See: *Avant v. United States*, 165 F. Supp. 802 (E.D. Va. 1958).

Here, Appellant cannot setoff against his post-bankruptcy debt the alleged satisfaction of pre-bankruptcy obligations for customers' utility bills.

Appellant argues that the "evidence discloses that this \$5,599.95 was used to pay "'creditors of the estate"—and *after* bankruptcy." (App. Op. Br. p. 23.) However, the crucial factor, even assuming these creditors were so paid, is that the debts in question for utility services arose prior to bankruptcy. The time of the actual payment, as such, is irrelevant.

Thus, Appellant's argument that a creditor who owes the Trustee money can relieve himself of this obligation by paying a pre-bankruptcy debt of the bankrupt ignores Section 68 of the Bankruptcy Act (11 U.S.C. Section 108), frustrates one of the main policies of the

Act—equality of distribution to creditors. (See; *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L. Ed. 1293, 1298 (1941)), and sanctions a preference (*Bankruptcy Act*, Section 60a(1), 11 U.S.C. Section 96a(1)).

In brief, it would force the Trustee, who has a claim for \$5,400.00, to accept in satisfaction thereof the payment of another debt which the Trustee would not have to pay in full but only pro rata, thus depleting the assets otherwise available for distribution to general creditors. For the above reasons alone, Appellant's argument must fall.

4. Additionally, it should be noted that the sum of \$17,688.21 was inexplicably withdrawn from the bankrupt and could not be accounted for by a meticulous examination of its books and records. [Rep. Tr. pp. 325-329; Ex. HH.] Also, there was a merchandise shortage of \$16,548.41. [Rep. Tr. pp. 200-206; Ex. S pp. 10-11.] These unexplained withdrawals and merchandise shortages occurred when Appellant was in complete control of the bankrupt and had full access to its bank accounts and cash registers. [Ex. M pp. 76-79, 84-91.] The Referee was aware of these facts when he denied Appellant any additional setoff above \$900.00.

6. The application of a setoff under Section 68(a) of the Bankruptcy Act has been held merely permissive, not mandatory. Its invocation rests in the sound discretion of the Court.

See:

Cumberland Glass Manufacturing Company v. De Witt, 237 U.S. 447, 59 L. Ed. 1042 (1915);

Collier on Bankruptcy, 14th Ed. Vol. 4, Section 68.02, p. 711.

Appellant has failed to demonstrate any abuse of discretion by the Court.

By reason of the foregoing, the Court below acted entirely within the law and its discretion in not allowing a further setoff.

II.

Appellant's Withdrawal of \$20,000.00 Constituted a Constructive Fraud on Creditors.

(1) Appellant Abused His Fiduciary Position by Obtaining Funds From an Insolvent Corporation to the Detriment of Other Creditors.

The Trustee of a Bankrupt Estate is vested by operation of law with the title of the Bankrupt as to "property transferred by him in fraud of his creditors."

Bankruptcy Act, Section 70a(4);

11 U.S.C. Section 110a(4).

"A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Bankruptcy Act, Section 70e(1);

11 U.S.C. Section 110e(1).

It is clear that Appellant's acts herein constituted a fraud upon the creditors of bankrupt.

" 'Each case must be considered on its own facts. [Citation] In its generic sense, constructive fraud comprises all acts, omissions and concealments involving a breach of legal or equitable duty, trust or confidence, and resulting in damage to another. (Citations)' "

Efron v. Kalmanovitz, 226 Cal. App. 2d 546, 559-560 (1964), quoting from *Estate of Arbuckle*, 98 Cal. App. 2d 546, 559-560.

The undisputed evidence establishes that Appellant, while in complete command and domination of the bankrupt, wrongfully favored himself over all other creditors by withdrawing a total of \$20,000.00 when the bankrupt was insolvent and immediately prior to the institution of bankruptcy court proceedings against it. The court below correctly ruled that such acts of the Appellant, under both Federal and California law, constitute a constructive fraud on the other creditors to whom he occupied a fiduciary position.

Pepper v. Litton, 308 U.S. 295, 84 L. Ed. 281 (1939), is a leading Federal case supporting the proposition that an officer or director of an insolvent corporation, and *a fortiori* one who completely dominates, controls and manipulates such a corporation [Clk. Tr. pp. 28-29, para. VIII], owes a fiduciary duty to creditors. As stated at pages 306-307 (84 L. Ed. 281, 289-290):

“A director is a fiduciary. *Twin-Lick Oil Co. v. Marbury*, 91 US 587, 588, 23 L ed 329, 330. So is a dominant or controlling stockholder or group of stockholders. *Southern P. Co. v. Bogert*, 250 US 483, 492, 63 L ed 1099, 1107, 39 S Ct 533. Their powers are powers in trust. See: *Jackson v. Ludeling*, 21 Wall. 616, 624, 22 L ed 492, 495. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction

but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. *Geddes v. Anaconda Copper Min. Co.*, 254 US 590, 599, 65 L. ed. 425 432, 41 S Ct 209. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside. While normally that fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is, in the event of bankruptcy of the corporation, enforceable by the trustee. For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders.” (Footnotes omitted.)

Thus, under equitable principles of Bankruptcy law, Appellant violated his fiduciary duty to the other creditors in preferring himself in the payment of his debt at a time when the bankrupt was insolvent, as shall be hereinafter more fully discussed. Withdrawing \$20,000.00 from such insolvent corporation which Appellant controlled and dominated, seriously damaged such other creditors since that sum was not available for distribution on a pro rata basis to them.

Appellant was likewise guilty of a constructive fraud under prevailing California law.

In *Bonney v. Tilley*, 109 Cal. 346 (1895), a director purchased debts of an insolvent corporation at a discount, and then endeavored to collect them at full face value.

At page 351 of the *Bonney* case, "Morawetz on Corporations" was quoted with approval by the California Supreme Court:

"Directors of an insolvent corporation who have claims against the company as creditors must share ratably with the other creditors in a distribution of the company's assets. They cannot secure to themselves any advantage or preference over other creditors by using their powers as directors for that purpose. These powers are held by them in trust for all the creditors, and cannot be used by them for their own benefit. It is to be observed, however, that a person who is a creditor of an insolvent corporation is not deprived of any of his rights as creditor by the fact that he also occupies the position of director of the company. He is merely incapacitated as director from using any of the powers of his position for his own benefit or the benefit of his codirectors."

In *Title Insurance and Trust Company v. California Development Company*, 171 Cal. 173 (1915), the Southern Pacific Company loaned large amounts of money to California Development Company to finance an irrigation system extending from the Imperial Valley to Mexico. In consideration of this loan, Southern Pacific Company obtained complete control over California Development Company and its Mexican subsidiary. Southern Pacific Company then arranged for judgment to be entered against the Mexican subsidiary and executed upon the property located in Mexico, thus procuring a preference in favor of itself as against the bondholders of the company. The Supreme Court refused to allow this transaction to stand, holding that directors of an insol-

vent corporation violate their fiduciary obligation when they prefer themselves in the disposition of assets which would otherwise be available to general creditors.

At page 206 of *Title Insurance and Trust Company, supra*, the court stated:

“Having such control and dominion over the development company and its subsidiary, the Southern Pacific Company occupied a fiduciary relation toward the California Development Company and its stockholders and creditors. We entertain no doubt of the soundness of the claim made by respondents that the Southern Pacific Company, by thus taking control of the directorate and the business of the development company, rendered itself subject, at least to the restrictions which are imposed upon a director of a corporation. It was a creditor of the development company, and it has seen fit to make its advances without exacting the security of any mortgage or lien upon the real or personal property of its debtor except the pledge of six thousand three hundred shares of the stock of the Mexican company. The Court finds that . . . prior to the obtaining of the judgments in the Mexican courts, the California Development Company was insolvent, and that this fact was known to the Southern Pacific Company.

Also see:

Heim v. Jobses, 14 F. 2d 29, 34 (8 Cir. 1926):

“The great weight of judicial authority supports the rule that, where a corporation is insolvent, its officers and directors must not use the assets of the corporation to prefer themselves as creditors to

the prejudice of other general creditors. [Citations.] This rule is founded upon the principle that it is inequitable that a director, whose position affords him knowledge of the condition of the corporation and power to act for it, should be permitted to take advantage thereof and protect his own claim to the detriment of others, at a time when it is apparent that all the unsecured debts of the corporation cannot be fully paid. [Citations.]”

Hanson v. Choynski, 180 Cal. 275, 285 (1919):

Reaffirming the principle that a “director who is at the same time a creditor is precluded from using his position as director to obtain a preference over other creditors in the payment of his own claims.”

Nixon v. Goodwin, 3 Cal. App. 358, 363 (1906):

“The rule is that a director of an insolvent corporation cannot receive to himself any preference or advantage over other creditors in the payment of his debt (*Bonney v. Tilley*, 109 Cal. 346, (42 Pac. 439)); and surely the same rule would apply with equal force to one who is a large creditor of the corporation of which he is a director and the president, and who resigns to-day that he may tomorrow (secretly as to all other creditors) accept a conveyance to himself of the corporation’s property.”

Appellant attempts to factually distinguish *Bonney v. Tilley*, 109 Cal. 346 (1895) and *Title Insurance & Trust Company v. California Development*, 171 Cal. 173 (1915), on the one hand, and this case, on the other hand, and implies the alleged distinction renders the

principle there enunciated inapplicable here. (App. Op. Br. pp. 27-28.) This contention is incorrect.

The facts show that on January 26, 1961, Appellant loaned the bankrupt \$20,000.00. At this point, Appellant was a creditor on a par with other creditors. On February 8, 1961, and again on February 20, 1961, Appellant cashed two checks, each in the amount of \$10,000.00 which he had caused the bankrupt to issue to him. Appellant completely dominated, controlled and manipulated bankrupt which admittedly was his *alter ego*. [Clk. Tr. pp. 28-29, para. VIII.] On these two dates, February 8th and February 20, 1961, while the bankrupt was insolvent, Appellant violated and abused his fiduciary position by securing for himself an advantage which was denied other creditors. While other creditors had to share in the remains of Appellant's moribund corporation, Appellant received one hundred cents on the dollar for his loan of \$20,000.00.

Hence, the principle set forth in the above mentioned cases is controlling here: A corporate officer or director of an insolvent corporation, and by necessary extension one who wholly dominates such a corporation, can not abuse his fiduciary obligation to creditors by securing an advantage for himself at their expense. Such is plainly what happened here and the Court below properly and justly set aside the \$20,000.00 payment to Appellant.

Appellee concedes that Appellant, upon the return of the \$20,000.00, in compliance with Bankruptcy Act Section 57n (11 U.S.C. Section 91n), will be entitled to share in a pro-rata dividend along with other general creditors to the extent of the \$20,000.00 claim. This will put Appellant in the same posture as such other creditors and he should have no cause to complain.

(2) The Evidence Clearly Establishes That Bankrupt Was Insolvent on February 8, 1961 and February 20, 1961.

Courts have recognized that insolvency is not always susceptible of direct proof, but frequently must be determined by considering factors from which the ultimate fact of a plus or minus net worth must be inferred or presumed.

See:

Rosenberg v. Semple, 257 Fed. 72, 73 (3rd Cir. 1919);

Hassan v. Middlesex County National Bank, 333 F. 2d 838 (1st Cir. 1964).

In this case, the usual difficulties in establishing insolvency were compounded by the bankrupt's complete failure to keep or maintain adequate books or records of its financial transactions. No general ledger, cash receipts journal or cash disbursements ledger could be found, despite a search of five and one-half days for these and other records. [Rep. Tr. p. 63; Trustee's Ex. S p. 102, lines 12-14.]

To deal with this financial wasteland, Appellee engaged Thomas M. Mulherin, a Certified Public Accountant with imposing qualifications. Mr. Mulherin graduated from Benjamin Franklin University, Washington, D. C., in 1929 with an Accounting Degree. He then joined the Federal Bureau of Investigation and worked as a Special Agent from June, 1929, until March, 1953, the major part of his work consisting of accounting investigation. In addition to his extensive F.B.I. experience, Mr. Mulherin has been Supervisor of Accounting in the City of New York, and has engaged in all types of accounting duties and investigations.

Since 1946, Mr. Mulherin has been a Certified Public Accountant of California. A major portion of his work consists of bankruptcy matters before the Courts. [Rep. Tr. pp. 60-61.]

Mr. Mulherin made a meticulous search to discover all possible records of bankrupt upon which to base his determination of solvency or insolvency. However, he could find no records of bankrupt other than bank statements, cancelled checks, certain journal sheets, a letter from McDaniel's Market covering the initial acquisition of the market and certain daily reports of sales. [Rep. Tr. pp. 62, 63, 65.]

To supplement the fragmentary records maintained by bankrupt, Mr. Mulherin talked to the C.P.A who was supposed to have set up the records and worked on them. [Rep. Tr. p. 63.] He searched the files of the Trustee and the attorney for the Trustee. [Rep. Tr. p. 63.] He went through the claims file in the Bankruptcy Court. [Rep. Tr. p. 63.] He reviewed all the exhibits and testimony in the Bankruptcy Court reflecting previous proceeding in this matter. [Rep. Tr. pp. 63-64.] He talked to Clyde B. White, the manager of the store's food department, Steve Dadigan, general manager, and Sam Jonas, the Trustee. [Rep. Tr. p. 64.]

Based upon his extensive investigations, and in view of the paucity of financial data maintained by bankrupt, Mr. Mulherin in determining bankrupt's fiscal status, used the only rational approach possible which, briefly summarized, was as follows [Rep. Tr. pp. 67-70, 138-139, 163-172; Ex. 5]:

Mr. Mulherin took the capital investment of \$100.00 as of the start of the business. [Rep. Tr. p. 175.] Other advances were treated by the officers as loans. [Ex.

M p. 29; Ex. N p. 70.] To the capital investment of \$100.00, Mulherin added the profits to the dates in question less known losses and expenses of operation but not including payables arising from acquisition of inventory, since these payables as of a given date could not be determined because of bankrupt's lack of records. [Rep. Tr. pp. 221-223.] Subtracting the original capital equity of \$100.00 plus the profits to the dates involved from the total expenses and losses incurred, Mulherin derived the amount of capital deficiency or insolvency as of the respective dates.

Thus, on February 4, 1961, there was a capital impairment or insolvency in the amount of \$52,114.00; on February 13, 1961, in the amount of \$47,857.00; and on February 20, 1961, in the amount of \$46,177.00. [Ex. S p. 4.]

There is an abundance of evidence supporting and corroborating the determination of insolvency, and the reasonableness and adequacy of Mr. Mulherin's analysis. Thus, as more fully appears in the Statement of Facts. (Appellee's Brief, *supra*):

Clyde B. White, a former manager of Bankrupt and connected with the grocery business since 1935 [Rep. Tr. pp. 71-72, 84-85], testified regarding Bankrupt's average retail markup [Rep. Tr. pp. 88-92] and also that he observed Mr. Jonas search for records. [Rep. Tr. p. 77.]

Mr. Sam Jonas, the trustee, testified he searched for records but found none of the standard records usually kept in a normal business operation [Rep. Tr. p. 108], except for some checks, some invoices, a record of gross receipts [Ex. Q], and a daily record of sales. [Ex. R; Rep. Tr. pp. 109, 111-112.]

Naum Tabachnick, a Certified Public Accountant, testified that his firm was retained as Bankrupt's accountant but they never set up a general ledger or a journal book for cash disbursements. [Rep. Tr. pp. 129-130.]

Ardell Welchance, Bankrupt's former bookkeeper, identified the four yellow pages of Ex. Q [Rep. Tr. p. 269] and certain pages in Exhibit R as being his handwriting. [Rep. Tr. pp. 277-280.]

A number of records and documents were also introduced and are listed in Footnote 1 of the Statement of Facts. (Appellee's Brief, *supra*.)

Despite all the above, Appellant disputes the computation of insolvency. He lists a number of assets and states that no evidence was introduced as to their fair market value or fair saleable value. (App. Op. Br. pp. 32-33.) Appellant claims that Mulherin did not take into account cash on hand and in the banks belonging to bankrupt, and that Mulherin did not give any consideration to the inventory on hand which Appellant claims was substantial. These items, of course, were fully considered by Mulherin, but were not separately computed as assets because of the offsetting liabilities which pertained to each—liabilities which could not be determined specifically because of the bankrupt's (and, in effect, Appellant's) own failure to keep books and records. [Rep. Tr. pp. 221-223.]

It would, indeed, be anomalous if the bankrupt could fail to keep or secrete records so that they could not be found by the Trustee, and then complain because of the failure to utilize computations which could only be made from such records. To do so would result in shielding one wrong through the perpetration of another.

See:

California Civil Code, Section 3517.

The cash, which Appellant claims was not considered by Mr. Mulherin, could have only three possible sources. Either it was contributed as a part of the initial capital investment, or it arose from a gross profit on sales, or it arose as a result of a loan to the bankrupt. To the extent that the source of the cash was capital investment or gross profit on sales, it was, of course, taken into account by Mr. Mulherin, as indicated by the analysis made by him above described. To the extent that the cash resulted from a loan to the bankrupt, it would not create capital equity because of the equal and offsetting liability to repay the loan. Thus, the amount of available cash was taken into consideration by Mulherin in his determination of insolvency.

Similarly, the amount of inventory on hand was not ignored by Mr. Mulherin's approach. The inventory properly would be valued at acquisition cost; such cost of acquisition would be represented either by a cash disbursement or an accounts payable liability and would, therefore, not affect the amount of capital equity or deficit.

The beer and wine license and the sublease (App. Op. Br. p. 33) were also considered by Mr. Mulherin in a manner similar to the above: The beer and wine license and sublease had to be acquired either with cash or by a payable, and in either case, the source of the funds for acquisition ultimately was an equal and offsetting payable. Therefore, these items did not create capital equity.

Appellant mentions accounts receivables and credits as assets of the bankrupt. (App. Op. Br. p. 17.) How-

ever, due to the bankrupt's failure to maintain adequate records, Appellee and Mr. Mulherin were unable to discover any evidence of accounts receivable or credits, and Appellant failed to introduce one shred of evidence that sustains to any degree a contention that any such items ever existed.

Appellant objects to the treatment accorded the alleged equity in the Santa Ana apartments which he transferred to the bankrupt in exchange for a \$60,000.00 note. (App. Op. Br. pp. 14-16.) Mr. Mulherin construed this transaction as resulting in a \$55,500.00 loss to the bankrupt, since there was no equity in the apartments, and Appellant was generously allowed a credit for \$4,500.00 in rents collected from tenants at the apartments.

That bankrupt never had any equity whatsoever in the property is demonstrated by the following:

The Santa Ana apartments were purchased on November 24, 1959, from Richard and Donna Corenson. [Ex. M pp. 95-96; Ex. E.] Internal Revenue Stamps on the Deed in the amount of \$45.10 and Appellant's testimony indicate a total consideration of \$41,000.00 [Ex. M p. 97] over and above the First Deeds of Trust which totalled \$150,000.00 [Ex. M p. 97; Ex GG.] There is some ambiguity as to who actually paid the \$41,000.00 for the apartments. The Deed shows Vine-more Company as the Grantee [Ex. E] but Appellant claims that he actually paid the consideration and Vine-more Company was holding the property for him. [Ex. M pp. 100-101.]

In brief, then if the apartment house property was worth only \$41,000.00 as of November 24, 1959, and thereafter an additional \$42,000.00 encumbrance was

placed upon it, the Referee could well conclude there was little, if any, equity when Appellant transferred this property to the bankrupt on February 2, 1961 less than a year and three months later.

See:

Miller v. United States, 125 F. 2d 75 (9th Cir. 1942);

County of Los Angeles v. Faus, 48 Cal. 2d 672 (1957).

The bankrupt thus received no value for the \$60,000.00 note which Appellant caused to be given to him for such acquisition. Indeed, it is significant that there was a default in principal and interest due under the First Deeds of Trust and the Trustor had failed to pay real estate taxes for the second one-half year, 1959-1960, and the full year, 1960-1961. [Ex. G-G.]

Furthermore, the Santa Ana apartments were sold by the holder of the First Deeds of Trust at a price that did not cover any portion of the \$42,000.00 worth of Second Trust Deeds, thereby corroborating that the bankrupt failed to receive any equity in the property. [Ex. GG.]

It is true that the sale took place on December 15, 1961, some ten months after the specific dates in question. However, the lower Court did not have to ignore this persuasive evidence as to the worth of the equity, but could consider it along with the other evidence to conclude that bankrupt received no value whatsoever when the Santa Ana apartments were deeded to it.

Many cases have allowed evidence of prices realized at an assignee's sale occurring subsequent to the date

of a preferential transfer to be retrojected to establish insolvency at the time of the prior preferential transfer.

See: *Healy v. Wehrung*, 229 Fed. 686 (9th Cir. 1916). (The results of a subsequent Trustee's sale were relied on to establish insolvency at an earlier date);

Mizell v. Phillips, 240 F. 2d 738 (5th Cir. 1957). (Evidence of the price brought at a subsequent Trustee's sale lends probative force to the asset evaluation as of the date of a prior preference and is competent evidence to establish insolvency);

Langham, Langston & Burnett v. Blanchard, 246 F. 2d 529 (5th Cir. 1957). (Allowing the value of the assets sold by the Trustee to be retrojected about nine months to a prior date for the determination of insolvency as of the prior date).

In re Great Western Biscuit Company, 85 F. Supp. 314 (S.D. Calif. C.D. 1949), contains the following language as to retrojection, at page 315:

"However, when the date is near and there is continuity or no change of position, the Referee may, in addition to the opinion of experts, draw his own inferences from the wretched financial condition of the bankrupt at the time of adjudication and infer bankruptcy as of the prior date. I did this myself *In re Rand Mining Company*. [71 F. Supp. 724] where I found insolvency despite the fantastic opinion as to the value of mining properties reflected on the books."

Here, the proof that no equity was realized at the foreclosure sale of the Santa Ana apartments can be retrojected to the dates of the transfer to show that

the bankrupt received no consideration for its \$60,000.00 note. Indeed, Appellant has introduced no evidence at all to indicate the lower Courts abused its discretion in concluding bankrupt had no equity in these apartments.

Appellant contends that the equity in the Santa Ana apartments was between \$30,000.00 and \$36,000.00 based upon his own testimony [Rep. Tr. pp. 315-316; App. Op. Br. p. 32], which is not even consistent since at one point he claimed the equity was worth \$60,000.00. [Ex. M p. 73.] There is, however, no evidence to sustain this contention of a \$30,000.00 to \$36,000.00 value other than the self-serving and contradictory statements of Appellant.

However, even accepting Appellant's estimation of value would still not vitiate the findings of insolvency on the two critical dates. If \$36,000.00 was subtracted from the amounts of capital impairment found by Mulherin [Ex. S p. 4], there would still be insolvency in the following amounts: \$16,144.00 on February 4, 1961; \$11,857.00 on February 13, 1961 and \$10,117.00 on February 20, 1961.

Appellant points to the Referee's Findings of Fact and Conclusions of Law of July 26, 1962, and the Order relating to objections to claims [Clk. Tr. p. 26], and contends these establish that Appellant and Holmby-Sunset Corp. made capital contributions to bankrupt of \$60,000.00 and \$42,000.00. This contention is completely erroneous in that; (a) Such findings and order merely subordinate the honoring of such claims to the prior payment of the allowed claims of other general creditors; and (b) the reference to "contributions of capital" was not *res judicata* herein since such deter-

mination was not necessary to the original decision, as shall hereinafter be more fully discussed.*¹

The "Order Re Objections to Claims of E. E. Hassen and Holmby-Sunset Corp." filed July 26, 1962 [Clk. Tr. p. 32], provides in part [Clk. Tr. p. 33]:

"IT IS HEREBY ORDERED, ADJUDGED
AND DECREED:

1. That the claim of E. E. Hassen originally in the sum of \$120,000.00 and reduced by stipulation in open court to the sum of \$60,000.00 and designated upon the court's records as claim No.

*¹The Findings of Fact and Conclusions of Law of July 26, 1962, arose under the following circumstances [Clk. Tr. p. 27, para. III and IV]:

"That on June 27, 1961, E. E. Hassen filed a claim herein, designated upon the court's records as claim No. 101, which claim alleged that the above named bankrupt was at or before the filing of the petition for adjudication of the bankrupt herein, indebted to him in the sum of \$120,000.00 for a 'balance due on property sold to bankrupt and monies advanced to bankrupt and Agreement of Compensation.'

That on July 13, 1961, E. E. Hassen, as president of Holmby-Sunset Corp., a California corporation, filed a claim herein, designated upon the court's records as claim No. 105, which claim alleged that the above named bankrupt was at or before the filing of the petition for adjudication of the bankrupt herein, indebted to said corporation by reason of the fact that the 'claimant (sic) received a note of \$42,000.00 in the form of trust deeds which was used to purchase stock from McDaniels Mkt. The note bears interest at 10%.'"

Appellant waived in open Court any claim to \$60,000.00 of the original \$120,000.00 claimed [Ex. M, pp. 3-5], and thus sought to recover from bankrupt as a creditor, the sum of \$60,000.00 plus \$42,000.00. Paragraphs X and XI of the July 26, 1962, Findings of Fact [Clk. Tr. pp. 29-30] recite that the sum of \$60,000.00 and \$42,000.00, respectively, were evidenced by promissory notes executed by the bankrupt. The \$42,000.00 note was payable to Holmby-Sunset Corp., a purported entity, that according to paragraph VI of said Findings of Fact and Conclusions and Order [Clk. Tr. p. 28], was completely managed, controlled and directed by Appellant.

101 be and the same hereby is allowed in the sum of \$60,000.00, payment of which sum to be and hereby is subordinated to the prior payment of the allowed claims of all other general unsecured creditors and no dividend shall be paid on said Claim No. 101 until and unless all other allowed claims have been paid in full.

2. That the claim of Holmby Sunset Corp. in the sum of \$42,000.00 and designated upon the court's records as claim No. 105 be and the same hereby is allowed in the sum of \$42,000.00, payment of which sum to be and hereby is subordinated to the prior payment of the allowed claims of all other general unsecured creditors and no dividend shall be paid on said Claim No. 105 until and unless all other allowed claims have been paid in full."

Also see: Conclusions of Law filed July 26, 1962, lines 11-28 [Clk. Tr. p. 31], to same effect.

The Order [Clk. Tr. pp. 32-33] amply demonstrates the nature of the Findings referred to by Appellant. Since Appellant launched a corporation with grossly inadequate capitalization, purportedly loaned \$60,000.00 and \$42,000.00 to the bankrupt, and made a claim for the return of said sums in bankruptcy proceedings, the repayment of these sums would be subordinated to the claims of all other general unsecured creditors. There is abundant authority for such subordination.

See:

Costello v. Fazio, 256 F. 2d 903 (9 Cir. 1958);
Boyum v. Johnson, 127 F. 2d 491 (8 Cir. 1942);
Bank of America v. Erickson, 117 F. 2d 796
(9 Cir. 1941).

The Court did not necessarily find that such sums were contributions of capital; if so, the Court would not, of course, have ordered that the sums be repaid to Appellant as a subordinated creditor.

Furthermore, even if the Court did determine, as Appellant claims, that the \$60,000.00 was a contribution to capital, such a finding would not be *res judicata* here, because it was in no way necessary or material to the decision or outcome of the specific proceeding before the Referee.

Notwithstanding the general rule that a finding on an issue is conclusive as to such issue in a subsequent action, a finding that is unnecessary and immaterial does not have such an effect.

See:

Sidebotham v. Robinson, 216 F. 2d 916 (9 Cir. 1954);

Lang v. Lang, 182 Cal. 765 (1920);

Bank of Visalia v. Smith, 146 Cal. 398 (1905).

As above stated, the proceeding upon which the July 26, 1962, Findings of Fact and Conclusions of Law were based, concerned the objections of Sam Jonas, Trustee to the allowance of the claim of E. E. Hassen, and that of Holmby-Sunset Corp. All that was necessary to the Court's decision was a determination that Hassen was not entitled to share in the assets on a pro rata basis with other creditors and that, therefore, his claim would be equitably subordinated to a prior payment of other creditors. It was by no means necessary or material to

the decision to determine that the advances were or were not capital contributions, and, therefore, such finding, even if made, would not be binding here.

Appellant further claims that the \$60,000.00 note should not be considered a liability because it was not due or matured, no demand for payment had been made and the note was only to be paid when bankrupt could pay it. (App. Op. Br. pp. 14, 33.) Characteristically, Appellant's argument ignores both the facts and the law. The \$60,000.00 note was payable on demand. [Ex. 2.] An instrument payable on demand matures immediately.

See:

O'Neil v. Magner, 81 Cal. 631 (1889).

The \$60,000.00 note was executed on February 2, 1961. [Ex. 2.] Therefore, on February 8, 1961, February 20, 1961, and every other relevant date after the execution of the note, bankrupt was obligated to pay \$60,000.00 without the necessity of a prior demand.

See:

Jones v. Nicholl, 82 Cal. 32 (1889).

Appellant's self-serving testimony that the note was to be paid only when bankrupt could pay it, varying as it does the terms of the demand instrument, violates the parol evidence rule and the Referee was free to disregard it.

See:

Bank of America etc. Association v. Pendergrass, 4 Cal. 2d 258 (1935).

Appellant sets forth a chart (App. Op. Br. pp. 26-27) purportedly reflecting receipts and payments by Appellant to or for the benefit of bankrupt. Appellant bewails the alleged fact that he contributed about \$94,200.00 for the benefit of bankrupt's creditors, without considering the Order involved herein for an additional \$52,000.00, while he purportedly withdrew only \$53,400.00.

This contention, like many of Appellant's arguments, is spurious and misleading. Appellant includes \$42,000.00 in the amount given to bankrupt. Appellant conveniently forgets, however, to include in the amount received from bankrupt a note for \$42,000.00 [Ex. 1] reflecting this loan, plus the \$60,000.00 note. [Ex. 2.] Appellant also neglects to mention that Mr. Mulherin's testimony reflects \$17,688.21 in cash disbursements unaccounted for [Rep. Tr. pp. 325-329; Ex. HH], and an inventory shortage in the amount of \$16,548.41 [Rep. Tr. pp. 200-206; Ex. S pp. 10-11] occurring during the time the bankrupt completely subservient to Appellant's will.

Thus, far from Appellant having cause to bemoan the alleged unfairness of the Order compelling him to return \$52,000.00, it is the creditors of bankrupt who have reason to complain. It was Appellant who launched bankrupt on its corporate existence with \$100.00 paid-in capital, an amount so insufficient that it was necessary for Appellant to loan the bankrupt \$20,000.00 before it even opened its doors for business. It was Appellant who controlled bankrupt during the time that \$17,688.21 in cash inexplicably disappeared. [Rep. Tr. pp. 325-329.] It was Appellant who controlled bankrupt during the time that a \$16,548.41 merchandise shortage oc-

curred. [Rep. Tr. pp. 200-206.] It was Appellant who misappropriated \$5,400.00 in rents belonging to the Trustee in Bankruptcy. It was, in fact, Appellant who set up this entire villainous scheme and controlled it and misguided it to its predictable conclusion: the loss of \$69,633.92 by creditors who, in good faith, supplied merchandise and services to the bankrupt. [Rep. Tr. p. 39; Exhibit 21].

III.

Appellee Is Entitled to Recover \$28,000.00 Wrongfully Appropriated by Appellant in Violation of the California Uniform Fraudulent Conveyance Act.

Appellant appropriated \$28,000.00 from the bankrupt on February 20, 1961. The sole purpose of this withdrawal of funds was to hinder, delay or defraud creditors, either Steve Dadigan, as conceded by Appellant, or Orange Empire, which had a claim for \$29,000.00 and ultimately was involved in placing a keeper on the premises. [Rep. Tr. pp. 72-76; Trustee's Ex. M pp. 43-44, 76-80, 85-93.]

Such an act is prohibited by the California Uniform Fraudulent Conveyance Act (Cal. Civ. Code §3439.07) which provides:

“Every conveyance made and every obligation incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.”

Where, as here, an actual intent to hinder, delay or defraud creditors is established, the insolvency of the transferor is not an issue.

Maguire v. Corbett, 119 Cal. App. 2d 244 (1953);

Alpha Hardware & Supply Company v. Ruby Mines Company, 97 Cal. App. 508 (1929);

In re Liquimatic Systems, Inc., 194 F. Supp. 625 (1961).

Appellant's removal of \$28,000.00 is also condemned by other sections of the California Uniform Fraudulent Conveyance Act. Thus, California Civil Code Section 3439.04 states:

"Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."

California Civil Code, Section 3439.03 sets forth:

"Fair consideration is given for property, or obligation:

- (a) When in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or
- (b) When such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained."

Appellant's actions clearly violate the above sections. Appellant was found to be insolvent. [Referee's Findings of Fact and Conclusions of Law, December 11, 1964; Clk. Tr. pp. 86, 87, para. III; p. 88, para. I; pp. 88-89, para. III.] This finding had ample support both in fact and in law. (See Appellee's Brief, Argument II, Section 2, *supra*.)

The California Uniform Fraudulent Conveyance Act, Section 3439.02(a) defines insolvency as follows:

"A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."

Also see:

Bankruptcy Act, Section 67d (11 U.S.C. Sec. 107d).

Because of bankrupt's lack of books and records, it was impossible to compute the salable value of its assets in a conventional manner, as heretofore discussed. [Ex. S p. 1, Appellee's Brief, Argument II, Section 2, *supra*.] Therefore, it was necessary to determine the value of assets based on the proposition that the amount of net assets would equal capital contributions plus gross profits to date. [Ex. S p. 4.] Thus, while bankrupt had assets of only \$22,057.00 as of February 20, 1961 it had expenses and losses of \$68,234.00. [Ex. S p. 4], plus substantial additional liabilities for goods and services never paid for, as evidenced by the filing of \$69,633.92 in creditors claims [Rep. Tr. p. 39; Exhibit 21.] A major portion of the \$68,234.00 expenses and losses arose from a demand note for \$60,000.00 issued by bankrupt to Appellant which was mature ever since its issue date of February 4, 1961. [Ex. 2.]

See:

O'Neil v. Magner, supra, 81 Cal. 631 (1889);
Jones v. Nicholl, supra, 82 Cal. 32 (1889).

Clearly, then, there was insolvency as defined by the California Uniform Fraudulent Conveyance Act.

In addition to insolvency, there was no fair consideration present for the \$28,000.00 withdrawal from bankrupt's account. The question of the fairness of consideration must be approached from the standpoint of creditors.

See:

Patterson v. Missler, 238 A.C.A. 877 (1965).

Here, the general creditors of the estate in no sense derived fair consideration from Appellant's misappropriation. Neither did the alleged repayment by Appellant constitute fair consideration, because judged from the point of view of general creditors, nothing was returned. Some \$13,000.00 of the money allegedly returned was admittedly used to prefer one creditor, McDaniel's Market [Rep. Tr. p. 198], to the detriment of other creditors who would have otherwise shared pro rata to the extent of the \$13,000.00. In fact, Appellant admits that none of the money allegedly returned was received by Appellee or creditors of the estate as such. [App. Op. Br. pp. 36-37; Clk. Tr. p. 89, lines 3-10.] Appellant contends, however, it is immaterial that creditors of the estate did not receive repayment since a preference action under Bankruptcy Act §60 is not involved. This contention is erroneous because it dis-

regards the standard set forth in the above cases of judging the matter from the standpoint of creditors. Thus, irrespective of Appellant's actual intent, the appropriation of \$28,000.00 was wrongful because it was made when bankrupt was insolvent and without the presence of fair consideration. See: *California Civil Code*, §§3439.05, 3439.06.

Appellant apparently does not take serious exception to the above referred to facts. He claims, however, that even if these facts do constitute a fraudulent conveyance, the alleged return of some \$30,000.00 within ten days after the appropriation of the \$28,000.00 constitutes a defense to a cause of action based on fraudulent conveyance.

California law upholds the Referee and the District Court. A transferee who receives money with intent to defraud the transferor's creditors does not relieve himself of liability to the creditors by returning the money to the transferor.

In *Hickson v. Thielman*, 147 Cal. App. 2d 11 (1956), plaintiffs sued to annul certain fraudulent transfers made by defendant to his co-defendant children to avoid an execution under a judgment. Defendant contended on appeal that his daughter had returned \$1,500.00 and that, accordingly, it was error to hold her liable. The Court stated that if the daughter conspired with the others to defraud the plaintiffs and received the money with that intent and purpose, returning the money to defendant would not have relieved her of responsibility.

The circumstances in the instant case are indistinguishable from those in *Hickson*. Here, Appellant conspired with Jack M. Goldsmith and the bankrupt, his

alter ego, to obstruct a creditor. When Appellant removed the funds on February 20, 1961, the bankrupt was insolvent.

The amounts allegedly returned to the bankrupt were used to favor other creditors and did not inure to the benefit of the estate and were not available for its general creditors. [Trustee's Ex. M pp. 138-142; Rep. Tr. pp. 238-242, 253.]

Thus, where a prohibited transfer has been effectuated, the party involved cannot be rescued from the consequences of his tortious act by fostering a further unfair and wrongful scheme. Under the circumstances, Appellant made the illegal withdrawal at his peril, and his repayments failed to undo the damage inflicted upon the bankruptcy estate.

Furthermore, Appellant again ignores the evidence which shows that a minimum of \$17,668.21 was inexplicably withdrawn from the bankrupt at the time when Appellant was in complete control and had full access to its bank accounts. [Trustee's Ex. HH.] Appellant also disregards the proof that an inventory shortage of \$16,548.41 also occurred when Appellant was in complete control of bankrupt. [Rep. Tr. pp. 200-206; Ex. S pp. 10-11.] Indeed, Appellant failed even to take the stand in an attempt to explain or refute this evidence of cash and merchandise shortage.

For the foregoing reasons, Appellant has failed to demonstrate any error in the Court's ruling that the Appellee should recover \$28,000.00 wrongfully appropriated by Appellant.

IV.

Order Allowing Appellant to File General Claim if \$20,000.00 Was Paid Within Thirty Days Was Proper.

In the proceedings before the Referee, Appellant never sought to reserve the right to file a general claim if all or any part of the amount of Judgment was paid. Accordingly, it is too late to raise the issue by appeal in this proceeding.

See:

Century Furniture Co. v. Bernhard's, Inc., 82 F. 2d 706 (9 Cir. 1936).

The Honorable William M. Byrne, Judge of the United States District Court, did, however, voluntarily allow Appellant to file a general claim provided he returned the sum of \$20,000.00 within thirty days after rendition of the order. Such a procedure is specifically sanctioned by Bankruptcy Act, §57n (110 U.S.C. §91n) which states in part:

“ . . . Claims which are not filed within six months after the first date set for the First Meeting of Creditors shall not be allowed: *Provided, however*, . . . That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering

of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case."

It is evident that while Appellant may be entitled to file a claim herein if the \$20,000.00 is returned within the time prescribed, such right does not attach to the sum of \$28,000.00, which was fraudulently withdrawn to avoid an attachment. In the latter instance, Appellant is merely being required to make restitution of funds which never should have been removed, and for which no consideration was given. This is unlike the situation where a party is compelled to disgorge a preference and later is entitled to file a claim. Hence, the District Court properly distinguished between the \$20,000.00 transaction which involved Appellant taking advantage of his dominance of the bankrupt by wrongfully favoring himself over others in the satisfaction of his own debt, and the \$28,000.00 transaction in which no such debt or consideration was present. In brief, Appellant has no valid claim for \$28,000.00 even if such sum was restored.

See:

In re Sherk, 108 Fed. Supp. 144 (N.D. Ohio 1952);

Bankruptcy Act, Section 57g (11 U.S.C. Section 93g);

Cowans, Bankruptcy Law and Practice, Section 345, page 184.

Conclusion.

The record in this case amply establishes that:

- (a) The sum of \$5,400.00 was converted by Appellant from the bankrupt estate;
- (b) Appellant abused his fiduciary obligation and perpetrated a constructive fraud on the bankrupt's creditors when he withdrew the sum of \$20,000.00 at a time when the bankrupt was insolvent and was wholly controlled by Appellant;
- (c) Appellant violated the California Uniform Fraudulent Conveyance Act by withdrawing \$28,000.00 with the intent of delaying or hindering a creditor, and there was no fair consideration given by him therefor.

Appellee contends that the Appellant has failed to show that the Referee's decision was clearly erroneous, and submits that the July 9, 1965 order of the United States District Court, awarding Appellee damages in the sum of \$52,000.00, should be affirmed.

Respectfully submitted,

BUCHALTER, NEMER, FIELDS &
SAVITCH,

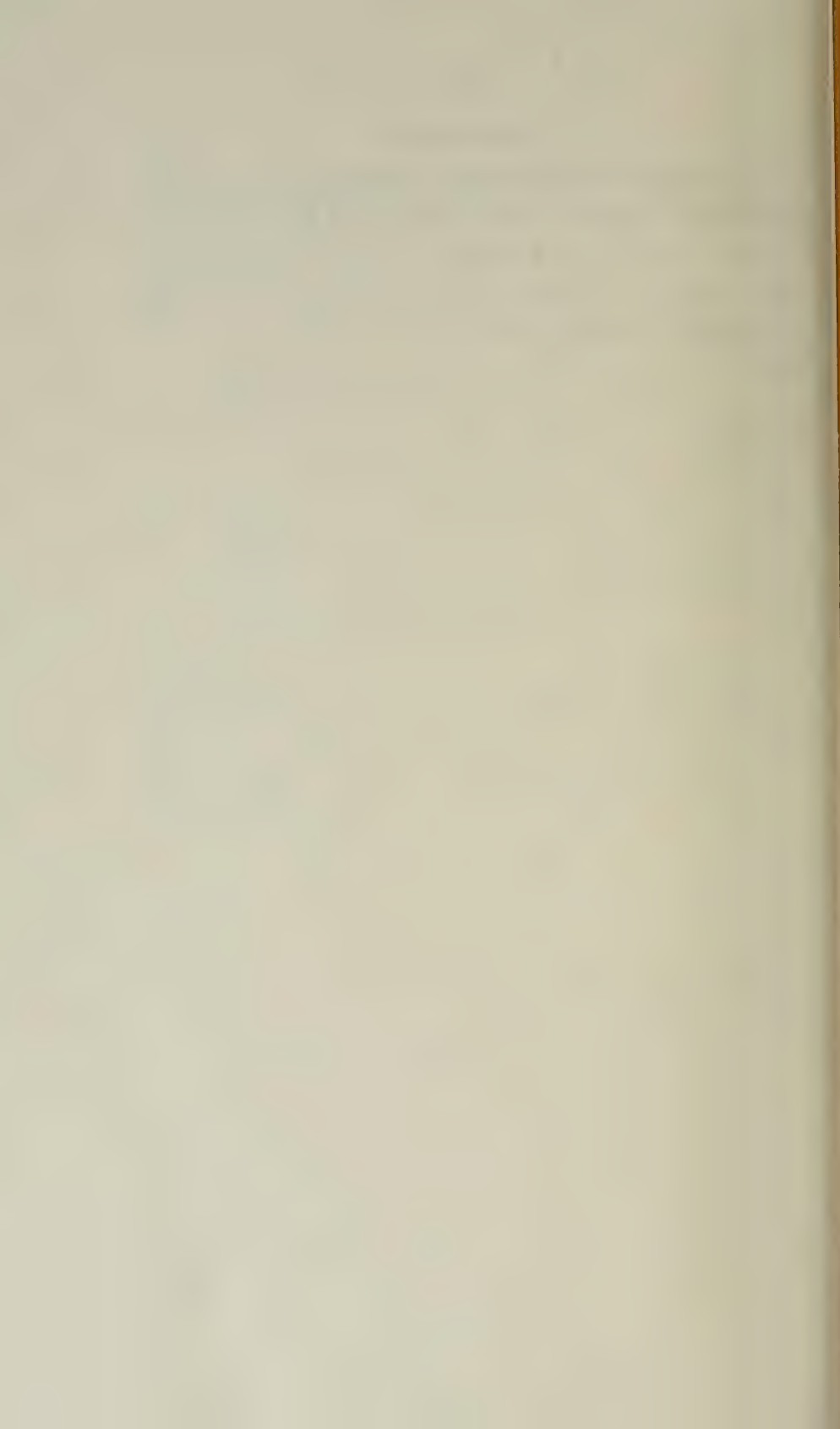
By BENJAMIN E. KING,
ROBERT H. THAU,

Attorneys for Appellee, Sam Jonas, Trustee.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT H. THAU



No. 20,415

MAR 7 1967

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, *et al.*,

Appellee.

APPELLEE'S PETITION FOR REHEARING.

BUCHALTER, NEMER, FIELDS &
SAVITCH,

By BENJAMIN E. KING,
ROBERT H. THAU,

727 West Seventh Street,
Second Floor,
Los Angeles, Calif. 90017,

Attorneys for Appellee, Sam Jonas Trustee.

FILED

MAR 3 1967

WM. B. LUCK, CLERK

MAR 3 1967

No. 20,415

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ERWIN E. HASSEN,

Appellant,

vs.

SAM JONAS, *et al.*,

Appellee.

APPELLEE'S PETITION FOR REHEARING.

*To the Honorable Stanley N. Barnes and Walter Ely,
United States Circuit Court Judges, and J. Warren
Madden, Judge of the United States Court of Claims:*

Appellee Sam Jonas, as Trustee of the Estate of Pomona Properties, Inc., doing business as Steve's Ranch Market, hereby petitions for a rehearing to consider the judgment entered by this Honorable Court on February 3, 1967, on the following grounds:

I

As to the \$28,000 transaction, the Opinion filed herein states that Appellant Erwin E. Hassen returned \$8,000 and \$14,000 to the bankrupt and later restored the remaining \$6,000 plus an additional \$2,000, and holds that

"Where the person responsible for the fraudulent transfer has himself remedied the situation by returning the transferred property, the statutory purpose has been satisfied." (pp. 4-5 of Opinion filed February 3, 1967).

The vice of this analysis is that:

(1) The funds were "returned" surreptitiously for the deliberate purpose of favoring certain creditors over

others, so that the general creditors were still deceived and thereby prevented from reaching the funds; and,

(2) The so-called restoration of funds did not remedy the harm caused by their fraudulent withdrawal.

The record shows that after Appellant Hassen wrongfully withdrew the sum of \$28,000, he merely resorted to another “cover-up” by placing the money in an account carried in the name of Jack Goldsmith [See Trustee’s Ex. M, pp. 138-142; Rep. Tr. pp. 238-242, 253]. Hence, Appellant Hassen did not truly and in good faith return the money; he merely continued to conceal it under another guise which prevented general creditors from attaching or otherwise pursuing it.

The question remains: Did the alleged payment by Appellant of certain debts repair the original damage. The answer properly must be in the negative, for the following reasons:

(a) Had Appellant not fraudulently taken \$28,000 from the bankrupt in the first instance, such sum would have flowed into the hands of the Trustee and ultimately been distributed to unsecured creditors on an impartial prorata basis; indeed, had an attachment been made, the fund would have been preserved so as to permit the Trustee to vacate the levy and thus benefit the creditors of the estate.

(b) Without dispute, the “return” of the money did not benefit the bankrupt estate or the unsecured creditors generally—excepting only in an “indefinite fractional amount.” (See p. 2 of Opinion).

(c) Since Appellant Hassen effectuated a fraudulent conveyance, the *burden* should repose solely upon him (not the Trustee) to establish that the damage thereby inflicted has been *fully and fairly rectified*—and no such proof was adduced here. To permit Appellant to fraudulently withdraw money, and then be deemed to

have "returned" it by paying selected creditors through a secreted bank account, frustrates the manifest purpose of the Uniform Fraudulent Conveyance Act, which is designed to prevent the very type of multiple manipulation which occurred here.

In other words, Appellee had the burden of showing that a violation of the Act had occurred. *But, that once having been established, the burden shifted to Appellant to demonstrate that he had fully repaired the harm.*

There was no credible proof, as this Court assumes, that Appellant repaid the money "indiscriminately" to creditors. *Due to Appellant's own derelictions, no adequate records existed to show whether the "restored" funds were or were not applied impartially.* Yet, having perpetrated the wrong, it became Appellant's duty to clearly demonstrate that such was the case.

(d) The fact, as was apparently relied upon in part by the Opinion herein (p. 4), that the Trustee failed to show he had pursued or recovered these payments as improper preferences on behalf of the bankrupt estate, vests no rights in Appellant. First, the records of the bankrupt were virtually incomprehensible or non-existent (see p. 3 of Opinion), so that a large share of the funds could not be specifically traced; second, not only were there no definite records of the amount allegedly paid to the utility companies—this payment was obviously made by Appellant for the self-serving purpose of seeking to shield himself from a charge of embezzlement (*i.e.*, the distribution by Appellant was not truly "indiscriminate" as p. 4 of the Opinion indicates); third, the payment to McDaniel's Markets effectively placed the funds beyond the reach of the Trustee, since such recipient itself was in due course involved in a Bankruptcy Court proceeding; fourth, there is no assurance that any such preference could have been set aside by the Trustee, since to be voidable the creditor must be shown to have had reasonable cause

to believe the debtor was insolvent and other particular requisites must be satisfied (Bankruptcy Act, Sec. 60, subdiv. b). In brief, Appellant's tortious withdrawal was made at the risk that his subsequent acts would not undo the original injury—and they did not do so.

The Opinion states that a torture was imposed upon the statute and that Appellant was made to pay a "penalty" (p. 6).

Appellee strenuously disagrees: the effect of this Honorable Court's decision is to inflict a penalty upon the general creditors of the estate, who by Appellant's admittedly fraudulent conduct were deprived of the fruits which an honest course of dealings would have produced.

The test on this appeal is whether the Referee committed clear error. Appellee is entitled to the benefits of not only all facts in the record, but all inferences which may be fairly deduced therefrom. When viewed in this light, the evidence shows that Appellant's entire pattern of conduct was fraudulent, and there is ample support for the Referee's specific finding that

"Respondent [Hassen] knew and had reasonable cause to believe that such funds would be so expended [*i.e.*, prior to initiation of bankruptcy court proceedings and in such manner that general creditors would not benefit] at the time he returned same to the Bankrupt." (Par. IV, p. 14 of Findings of Fact filed December 11, 1964).

Thus, this Honorable Court appears to have decided the case on the basis of the bare-bones fact that Appellant withdrew and "returned" the money—without due consideration for the bad faith nature of the alleged restoration and its lack of any significant benefit to the general creditors. The scope of this review requires as a matter of law that the Court accept all the evidence in the record which impeaches Appellant's claim of relief.

II

The Court erred in not following the prevailing California law as stated in *Hickson v. Theilman*, 147 Cal. App. 2d 11, 304 P. 2d 122 (1956).

In that case, plaintiffs sued to annul certain fraudulent transfers made by defendant to his co-defendant children to avoid an execution under a judgment. Defendant contended on appeal that his daughter had returned \$1,500.00 and that, accordingly, it was an error to hold her liable. The Court stated that if the daughter conspired with the others to defraud the plaintiffs, and received the money with that intent and purpose, returning the money to defendant would not have relieved her of responsibility.

The circumstances in this case are indistinguishable from *Hickson, supra*. Appellant Hassen conspired with Jack M. Goldsmith and the bankrupt, his *alter ego*, to obstruct creditors by concealing funds from the bankrupt. Once these funds had been removed, Appellant's fraudulent purpose of evading the creditors had been accomplished. "Returning" the money by paying certain other creditors in no way remedied the wrong which Appellant had accomplished as to Orange Empire, Steve Dadigan, and other unsecured creditors. Therefore, Appellant Hassen did not remedy the situation.

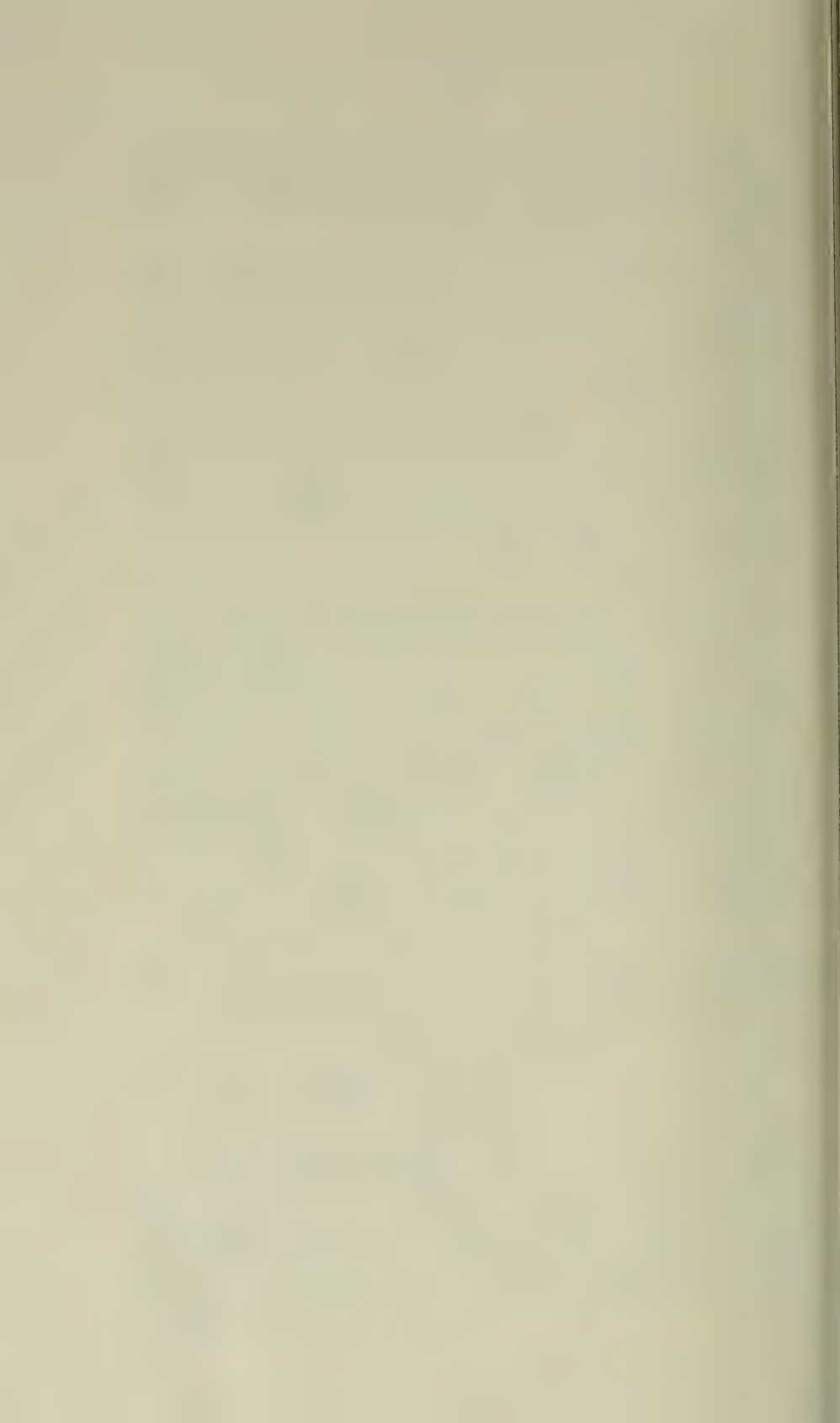
Wherefore, Appellee respectfully requests that this Petition for Rehearing be granted and the judgment of the District Court be affirmed in full.

Respectfully submitted,

BUCHALTER, NEMER, FIELDS &
SAVITCH,

By BENJAMIN E. KING,
ROBERT H. THAU,

Attorneys for Appellee Sam Jonas, Trustee.



Certificate.

Undersigned counsel certify that this petition is not interposed for delay and that in their judgment it is well founded.

Dated: March 3, 1967.

BENJAMIN E. KING

ROBERT H. THAU

Attorneys for Appellee

United States Court of Appeals
For the Ninth Circuit

RUSSELL L. IRISH, dba
RUSSELL L. IRISH INVESTMENTS,
Petitioner,
vs.
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

APPEAL FROM THE SECURITIES AND EXCHANGE
COMMISSION, WASHINGTON, D. C.

BRIEF FOR PETITIONER
(APPELLANTS)

FILED

MAY 25 1966

WM. B. LUCK, CLERK

T. DAN MORTIMER
OF REAUGH, HART, ALLISON,
MORTIMER & PRESCOTT
Attorneys for Petitioner

1100 IBM Building
Seattle, Washington

United States Court of Appeals
For the Ninth Circuit

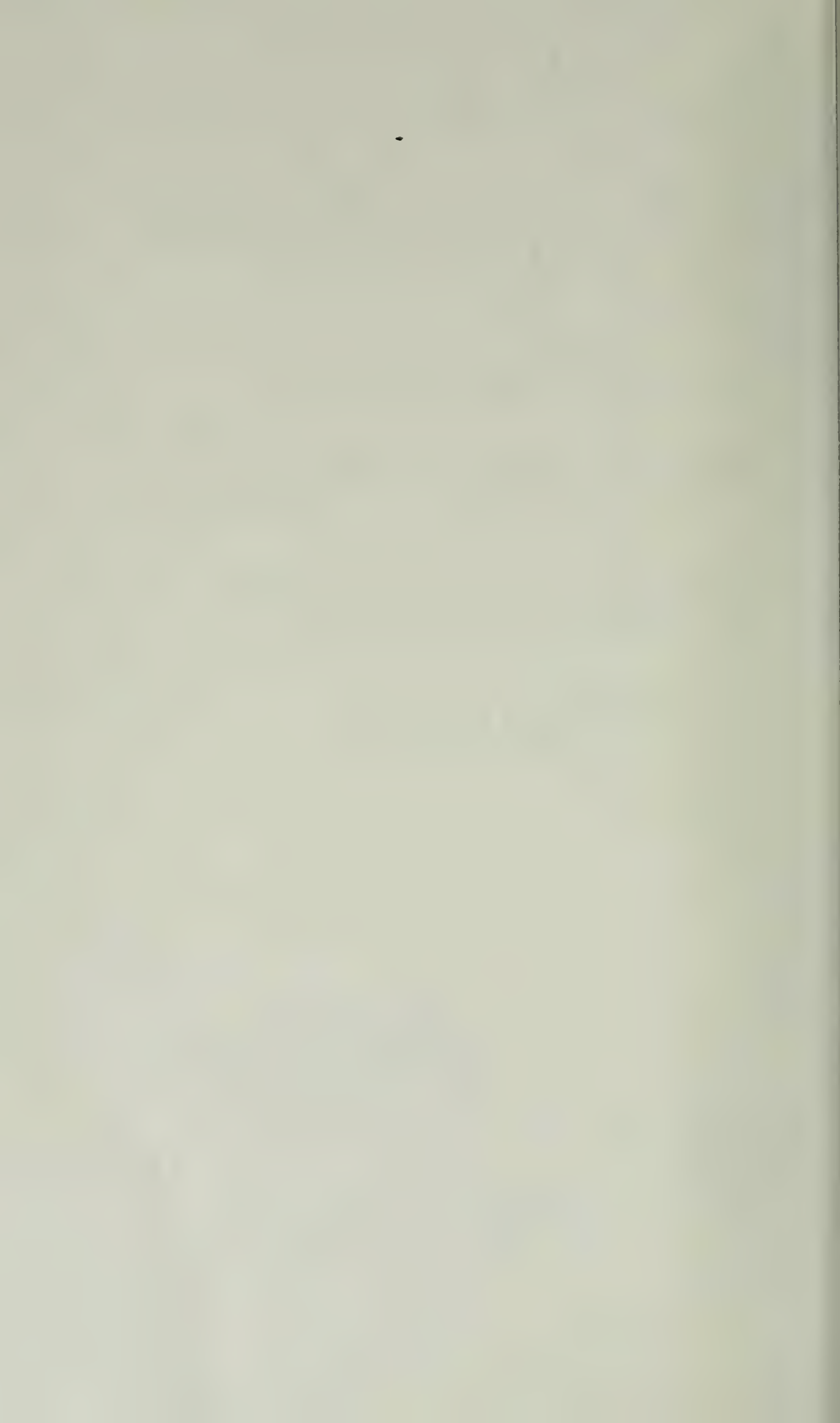
RUSSELL L. IRISH, dba
RUSSELL L. IRISH INVESTMENTS,
Petitioner,
vs.
SECURITIES AND EXCHANGE COMMISSION,
Respondent.

APPEAL FROM THE SECURITIES AND EXCHANGE
COMMISSION, WASHINGTON, D. C.

BRIEF FOR PETITIONER
(APPELLANTS)

T. DAN MORTIMER
OF REAUGH, HART, ALLISON,
MORTIMER & PRESCOTT
Attorneys for Petitioner

1100 IBM Building
Seattle, Washington



INDEX

	Page
TABLE OF CASES.....	iii
STATUTES AND MISC. AUTHORITY.....	iv
JURISDICTIONAL STATEMENT.....	1
STATEMENT OF THE CASE.....	2
SPECIFICATION OF ERROR.....	6
INTRODUCTION TO ARGUMENT.....	15
ARGUMENT.....	17
CONCLUSION.....	33

APPENDIX

1, 2, 3, 4, 5, 6,
7, 8, 9, 10, 11, 12,
13, 14.

TABLE OF CASES

<i>Accardi v. Shaughnessy</i> , 1953, 347 U.S. 260, 267.....	23
<i>Adler v. U.S., Ct. of Cl.</i> , 1956, 146 F. Supp. 956....	26
<i>American Broadcasting Co. v. FCC</i> , 1949, 179 F.2d 437.....	23
<i>Amos Treat and Company v. Securities and Exchange Commission</i> , 306 F.2d 260, 113 U.S. App. D.C. 100.....	18
<i>Behel Johnson</i> , 26 SEC. 163.....	29
<i>Cates v. Haderlein</i> , 1951, 342 U.S. 804.....	24
<i>Causey v. U.S.</i> , 240 U.S. 399, 402.....	22
<i>Chesapeake Canal Company v. U. S.</i> , 1919, 250 U.S. 123, 126.....	22
<i>Consumer Power Company</i> , 1939, 6 SEC. 444.....	25
<i>Costello v. U.S.</i> , 1960, 365 U.S. 265, 281-4.....	22

	<i>Page</i>
<i>Deering-Milliken v. Johnston</i> , 1961, 295 F.2d 856..	18, 24
<i>Engineering Public Service</i> , 1941, 10 SEC. 327.....	24
<i>Farmers Educational and Co-op Union v. Circuit Court of Charles Mix County</i> , 1950, 40 N.W.2d 402.....	33
<i>FTC v. Evis Manufacturing Company</i> , (9th Circ.) 287 F.2d 831 368 U.S. 824.....	26
<i>Guaranty Trust v. U. S.</i> , 1938, 304 U.S. 126, 135, 141.....	22
<i>Howard F. Hansell, Jr.</i> , 31 SEC. 393.....	19
<i>Jefferson Amusement Company v. FCC</i> , 1955, 226 F.2d 277.....	23
<i>Johannessen v. U.S.</i> , 1911, 225 U.S. 227.....	22
<i>R. H. Johnson and Co.</i> , 198 F.2d 690.....	30
<i>Kessler v. FCC</i> , 1963, 326 F.2d 673, 117 U.S. App. D.C. 130.....	18
<i>Lasdon v. Hallihan</i> , 1941, 36 N.E.2d 227.....	18
<i>Major v. Shaver</i> , 1951, 187 F.2d 211.....	22
<i>Mendell</i> , 31 SEC. 491.....	19
<i>Morland Theaters Corp. v. Portland Moving Pictures Machine Operators Protective Union</i> , 1932 12 P.2d 333, 140 Ore. 35.....	18
<i>Northern Pacific v. Boyd</i> , 1912, 220 U.S. 840, 842....	22
<i>Riss and Company v. U.S.</i> , 1951, 341 U.S. 907.....	24
<i>Rosenblum v. Rosenblum</i> , 1943, 42 N.Y.S.2d 626, 181 Misc. 78.....	18
<i>Sangamon Valley Television v. U. S.</i> , 1959, 269 F.2d 221.....	23
<i>SEC v. Bourbon Sales Corporation</i> , 47 F. Supp. 70....	32
<i>SEC v. Vacuum Can Company</i> , 157 F.2d 530.....	32
<i>Service v. Dulles</i> , 1956, 354 U.S. 363.....	23
<i>Sheridan-Wyoming Coal v. Krug</i> , 1949, 172 F.2d 282	23

<i>Smith v. Illinois Bell Telephone Company</i> , 270 U.S. 587, 46 S.Ct. 408, 70 L.Ed. 747.....	18, 22
<i>State ex rel St. Louis Union Trust Company v.</i> <i>Sartorus</i> , 1943, 171 S.W.2d 569, 351 Mo. 111.....	32
<i>Steen v. Los Angeles</i> , 31 Cal.2d 542, 190 P.2d 937.....	22
<i>Swift and Company v. U.S.</i> , 1962, 308 F.2d 849.....	18
<i>Thompson & McKinnon</i> , 1953, 35 SEC. 451.....	29
<i>Treat and Company v. SEC</i> , 1962, 306 F.2d 260, 113 U.S. App. D.C. 100.....	18
<i>Truax v. Corrigan</i> , 1921, 22 S.Ct. 124, 257 U.S. 312, 66 L.Ed. 254.....	18
<i>U.S. v. Ali</i> , 1925, 7 F.2d 728.....	22
<i>U. S. v. Missouri-Pacific Railroad Company</i> , 1928, 278 U.S. 269.....	23
<i>Utah Power and Light v. U.S.</i> , 243 U.S. 389, 409....	22
<i>Wesreb Oil Company</i> , SEC Release No. 4647, Sept. 30, 1963.....	19

STATUTES

5 United States Code Annotated 1009(e)....	2, 7, 23, 24
10 (b) Securities and Exchange Act of 1934.....	1
15A Securities and Exchange Act of 1934.....	1, 12
15(b) Securities and Exchange Act of 1934.....	1
15(c) (1) Securities and Exchange Act of 1934.....	1
17(a) Securities and Exchange Act of 1934.....	11, 26
17(a) Securities Act of 1933.....	1

SECURITIES AND EXCHANGE COMMISSION RULES AND REGULATIONS

Securities and Exchange Commission Rule 17CFR 240.10b-5	1
--	---

Securities and Exchange Commission Rule 17CFR 240.15c 1-2.....	1
Securities and Exchange Commission Rule X-17 (a) -3	12, 14, 26, 31
Securities and Exchange Commission Rule X-17 (a) -4	12, 14, 26, 31

SECURITIES AND EXCHANGE COMMISSION RULES OF PRACTICE

Securities and Exchange Commission Rules of Practice 201.13.....	7, 23, 25
Securities and Exchange Commission Rules of Practice 201.16.....	6, 23
Securities and Exchange Commission Rules of Practice 201.19.....	27
<i>Davis on Administrative Law</i> , Section 8.08, p. 550....	26
<i>Swartz</i> , "A Decade of Administrative Law: 1942- 1951." 51 Mich. Law Review, 775, 791-3 (1950)....	25

United States Court of Appeals

For the Ninth Circuit

RUSSELL L. IRISH, dba RUSSELL L. IRISH INVESTMENTS, <i>Petitioner,</i>	}	No. 20472
vs.		
SECURITIES AND EXCHANGE COMMISSION, <i>Respondent.</i>		

APPEAL FROM THE SECURITIES AND EXCHANGE
COMMISSION, WASHINGTON, D.C.

BRIEF FOR PETITIONER (APPELLANTS)

JURISDICTIONAL STATEMENT

Private proceedings were instituted on March 19, 1959, wherein Respondent issued an Order, pursuant to §§ 15(b) and 15A of the Securities Exchange Act of 1934 against Russell L. Irish, dba Russell L. Irish Investments, to determine whether Russell L. Irish and Russell Lawson Irish had wilfully violated § 17(a) of the Securities Act of 1933; § 10(b) of the Exchange Act, and Rule 17 CFR 240.10b-5 thereunder; and § 15(c) (1) of the Exchange Act, and Rule 17 CFR 240.15c1-2 thereunder. The purpose of the proceedings was to determine whether it was in the public interest to revoke or suspend the registration of Russell L. Irish, and whether to find Russell Lawson Irish a cause of any such order of revocation, suspension, or expulsion

(Tr. 2). The Court has jurisdiction on appeal from the Order of the Securities and Exchange Commission revoking the broker-dealer registration of Russell L. Irish and finding Russell Lawson Irish a cause of said Order, dated August 27, 1965 (Tr. 1421-1430). 5 USCA 1009.

STATEMENT OF THE CASE

The essential and most vital issue involved is whether Appellants were denied due process by the Respondent in the revocation of Appellant Russell L. Irish's broker-dealer license and finding Appellant Russell Lawson Irish as a cause thereof.

Appellants and Respondent, in their respective views of the evidence contained in the record, are at complete odds. Appellants claim arbitrary and dilatory acts of the Respondent denied the Appellants due process although Appellants had always urged the expeditious conclusion of these proceedings. Respondent contends the Appellants contributed to the prolongation of these proceedings. Appellants claim Respondent violated Respondent's own Rules of Practice and the Administrative Procedures Act. Additionally, Appellants contend the findings of the Respondent in its decision of August 27, 1965 (Tr. 1421-1430) are not supported by substantial evidence.

On March 19, 1959, Respondent ordered a private hearing held, said hearing being held in Spokane, Washington, September 21, 1959 through September 24, 1959; and a recommended decision was requested of the Hearing Examiner (Tr. 469).

Subsequent to that time by stipulation (Tr. 469) depositions were taken in this cause, one of Therese W. Benedict (Tr. 470-495) in San Francisco, California, on December 3, 1959, and filed December 24, 1959; deposition of Evan I. Evans (Tr. 496-516) was taken in Spokane, Washington, on June 20, 1960, and filed on July 6, 1960; deposition of Louis E. Alboucq (Tr. 517-527) was taken on February 24, 1961, in Spokane, Washington, and filed March 9, 1961; deposition of William A. Curry (Tr. 528-577) was taken on April 5, 1961, in New York City, and filed April 27, 1961; deposition of Daniel C. Raffaele (Tr. 578-592) was similarly taken on April 5, 1961, in New York City and filed on April 17, 1961.

Thereafter not until October 14, 1963, was there further activity by Respondent to close the subject hearing. At that time a motion to reconvene the hearing in these proceedings was filed by the Respondent (Tr. 1077-1081) which, under date of October 23, 1963, the Hearing Examiner denied and refused to certify such reconvening of the hearing to the Respondent (Tr. 1082-1083). The Hearing Examiner stated in part:

"The doctrine of laches on the part of the Division of Trading and Exchanges, now known as the Division of Trading and Markets, bars the Division from reviving these dormant proceedings which have been inactive for so much of the time since the hearing was closed on September 24, 1959.

"Furthermore, the concepts of fairness and due process require that proceedings such as these be prosecuted expeditiously and the Hearing Examiner is of the opinion that it will be unfair to the registrant and Russell Lawson Irish, the alleged 'cause', to resurrect this case after it has been in

such an inactive and dormant condition for so long."

Appellants then filed, on November 4, 1963, a "Motion for Stay of Proceedings Permanently or in the Alternative, Motion to Dismiss Proceedings and Motion for Leave to Argue the Same Orally Before the Commission" (Tr. 1087-1099).

On November 12, 1963, Respondent filed its "Application for Review of Hearing Examiner's Ruling of October 23, 1963 and Brief in Support Thereof and in Opposition to Respondent's Motion for Permanent Stay of Proceedings on Dismissal" (Tr. 1100-1126). The findings and brief were filed and on April 3, 1964, the Hearing Examiner issued his Order recommending that these proceedings against Russell L. Irish and Russell Lawson Irish, the Appellants, be dismissed (Tr. 1375-1395). The Hearing Examiner said in part in his recommended decision:

"Based upon the entire record in these proceedings, the Hearing Examiner is firmly of the opinion that it will be unfair to revoke the registrant's registration on the record that has become as stale as this and he finds that the public interest does not require it. If the registrant still continues his wrongful conduct, the Division of Trading and Markets can resort to the courts through the injunctive process or it can seek another order for proceedings from the Commission alleging new and later violations than those embodied in the extensively amended order under which these proceedings have been spasmodically kept alive for so long a time."

Thereupon, under date of August 27, 1965, the Respondent issued its Order overruling the Hearing Ex-

aminer's recommended dismissal, and held the Appellants effected excessive trading in mutual fund shares at prices above offering prices, effected sales of mutual fund shares in amounts below break points, and further found that the delay in the proceedings had not prejudiced the rights of the Appellants and revoked the broker-dealer registration of the Appellant Russell L. Irish and found the Appellant Russell Lawson Irish as the cause of the revocation (Tr. 1421-1430).

It is noteworthy that the Respondent had conducted its investigation from 1941 through 1959 (Tr. 938-1048). Further, the record contains documents from 1943 through 1963 (Tr. 1046-1061).

Prior to March 19, 1959, the National Association of Securities Dealers, hereinafter referred to as "NASD", of which Appellant Russell L. Irish is a member, filed a complaint against Appellant Russell L. Irish, and under date of October 15, 1955, suspended said Appellant from the NASD for a period of 15 days, fined Appellant the sum of \$3,000 and costs of \$6,830.11. This decision and penalties were not appealed by the Appellant to the Respondent nor was the Appellant represented by counsel during those proceedings. The Respondent as is its custom and by its own regulations then investigated and instituted these present proceedings de novo.

It is interesting to note that in the event Appellant had chosen to appeal the penalties of the NASD, the Respondent could have ordered supplementary hearings enlarging upon those proceedings of the NASD, but the penalties imposed by the NASD could not have

been increased by the Respondent, contrary to the present situation the Appellants now find themselves in.

The action of the NASD covered much the same time period and material as the Respondent has in the present proceedings, for which the NASD has already penalized the Appellants.

SPECIFICATION OF ERROR

The Securities and Exchange Commission erred in revoking Appellant Russell L. Irish's registration as a broker-dealer and further erred in finding Appellant Russell Lawson Irish as the cause of that Order, as follows:

1. Appellants have been denied due process of law;
2. Respondent's Division of Trading and Markets has been guilty of laches in its handling of the proceedings herein;
3. Respondent's Division of Trading and Markets violated Respondent's Rules of Practice 201.16 (e) which states:

"Time for filing proposed findings and briefs prescribed by hearing officer. At the end of every hearing, the hearing officer shall, after consultation with the parties, prescribe the period within which such proposed findings and conclusions and supporting briefs are to be filed and shall direct such filing to be either simultaneous or successive, provided, however, that the period within which the first filing is to be made normally should be no more than 30 days, and shall not exceed 60 days, after the close of the hearing. If successive filings are directed the proposed findings and conclusions of the moving party shall be set forth in serially numbered paragraphs and any counter-statement of proposed findings and conclusions must, in addition to any other matter, indicate as to which para-

graphs of the moving party's proposals there is no dispute. Reply briefs may be filed by the moving party or, where simultaneous filings are directed, reply briefs may be filed by all parties, within the period prescribed therefor by the hearing officer."

4. Respondent failed to provide expeditious proceedings under Respondent's Rules of Practice 201.13, which states:

"(a) *Commission or hearing officer may extend, postpone or adjourn.* Except as otherwise provided by law, the Commission at any time, or the hearing officer at any time prior to the filing of his initial decision or, if no initial decision is to be filed, at any time prior to the closing of the record, for cause shown, may extend or shorten any time limits prescribed by these rules for filing any papers and may postpone or adjourn any hearing."

"(b) *Limitation on extensions.* In no event shall any extension of time for filing papers granted by hearing officer pursuant to this rule exceed a total of 30 days.

"(c) *Limitations on postponements and adjournments.* A hearing before a hearing officer shall begin at the time and place ordered by the Commission, provided that, within the limits provided by statute, the hearing officer may for good cause postpone the commencement of the hearing for not more than 30 days or change the place of hearing. Any convened hearing may be adjourned to such time and place as may be ordered by the Commission or by the hearing officer. *It is the policy of the Commission that such adjournment shall be for not more than 30 days and in no event shall the hearing officer order an adjournment for a period in excess of 45 days.*" (Emphasis ours.)

5. Respondent failed to provide expeditious proceedings in violation of 5 USCA 1009(e);

6. The findings of the Respondent as to the facts

are not supported by the evidence contained in the record of these proceedings.

7. Exhibits were improperly admitted as evidence that are not relevant to the proceedings (Tr. 22-30 as follows:

Hearing Examiner: The witness is referring to a page in this particular exhibit.

Q. Handing you what has been marked as Exhibit 3, would you determine if that is a copy of the ledger sheet of your accounts?

A. This is a bad copy, but I would say that the entries are correct; and I recognize the hand writing.

Q. And whose hand writing is that?

A. Well, it might be two.

Q. Could you recognize it?

A. Yes, the first part of it appears to be Patricia Herboth's hand writing.

Q. Is there any change in it?

A. No, there is no change.

Q. I am handing you Exhibit 4 and ask you to look at that; I'll have you look at them all.

A. Well, I recognize Mrs. Benedict's writing — Mrs. Benedict's account rather, and then, Evan I. Evans' account, and Doctor Milo Harris' account, and I recognize the hand writing on that, and Johnnie R. Hughes, and Jacob C. Keller's, George Wagnild, and August J. Pfeifer, and Robert F. and Jennie Brauer, and Fred H. Senkler.

Q. So these sheets, Mr. Irish, which are marked Exhibits 1 through 13, that you have just identified, appear to be accurate photo copies of the ledger sheets

of those customers for the periods which they cover?

A. Yes, sir.

Mr. Fegan: Does counsel wish to examine these?

Mr. Mortimer: Not at the moment.

Mr. Fegan: I would like to offer these sheets at this time as Commission's Exhibits 1 through 13. Now, counsel may examine the thirteen exhibits if they care to.

Hearing Examiner: Off the record.

(Discussion off the record).

Hearing Examiner: On the record.

Mr. Mortimer: One thing which we want on the record is a right to object to the admission in evidence of these records.

Hearing Examiner: You are objecting on the ground that they are photostats?

Mr. Mortimer: No, on the contexts as to the period of time they cover; we are not objecting that they are improper photostats.

Hearing Examiner: Then, your objection does not go as to the fact that these are photostats of the original ledger sheets in the Registrant's office?

Mr. Mortimer: No.

Hearing Examiner: Well, what is the basis of your objection, then?

Mr. Campbell: If the Court pleases, sir, these records come down from a period of 1943 to a recent date, and just what it is, I can't be sure; it's 1957 I believe, and there is a question in our mind that records older than six years are irrelevant here. A man is required to keep records under two rules, one for two years and one for

six years, and we have no objection to the admission of anything six years old or younger. The mere fact that he has kept them for a hundred years doesn't make them admissable at this time, and we would like to object to anything older than 1953.

Mr. Mortimer: Specifically older than September 10, 1953.

Hearing Examiner: What do you have to say about this objection, Mr. Fegan?

Mr. Fegan: First of all, I would point out that the order of the Commission in this case relates information furnished by the staff for a period from approximately May 1, 1943, to approximately October 31, 1958, as the period on it. I am referring you on it to Paragraph II (b) as a period during which the Registrant corporation employed the device of scheme, engaged in alleged illegal transactions. As I understand counsel's objection, it would be that the Commission erred in charging in the order a transaction more than six years from the current date.

Mr. Mortimer: That would be correct.

Hearing Examiner: Well, it seems to me that Mr. Miller, when he was on the stand, made some mention of a six year period. It strikes me a period starting with May 1, 1943, and running down to approximately October 31, 1958, is a period of fifteen years, and I can't see how that a period of time running fifteen years is relevant to this present proceedings.

Mr. Mortimer: That is what we are trying to find

out.

Mr. Fegan: Your Honor, as I understand the statute, there is no time limit placed upon which the Commission may examine into the illegal conduct of a broker. The mail fraud statute, which might apply to in three or more cases, insofar as I know, is by no means made applicable to activities of a registered broker dealer, and I believe that there is no limitation in the law as to the time beyond which the Commission may go in determining whether a broker engaged in illegal conduct. I will grant it the rule — bookkeeping requirement rather.

Hearing Examiner: Well, what is involved in such a long period of time? Mr. Campbell — Mr. Mortimer, would you read the document from which you have picked this six years as being starting point?

Mr. Mortimer: There are the rules that modify and explain Section XVII (a) of the Securities and Exchange Act of 1934.

Mr. Fegan: What is that section?

Mr. Mortimer: It is X-17-3 and is entitled "Records to be made by certain Exchange members, brokers, and dealers," and it starts out Paragraph (a) "Every member of the National Securities Exchange who transacts a business in securities directly with others and members of the National Securities Exchange and every broker or dealer who transacts a business in securities through the medium of any member and every broker or dealer registered pursuant to Section XV of the Securities and Exchange Act of

1934, as amended, shall make and keep current the following books and records relating to his business," and then, Your Honor, it goes on to state what must be kept. Under Section 1, it states for a period of six years, and that is Rule X-17 (a)-4, describes the length of time they must be kept, and this (a)-3 describes what record to be kept, and in (a)-3, it states and describes that blotters and ledgers and so forth shall be kept six years, that certain financial records shall be kept . . . preserved for three years for inspection. I have a photostatic copy here that we might introduce into the record, on which I have made notations.

Hearing Examiner: Judicial notice can be taken of that; I don't see any need of putting it in the record.

Now, what have you to say about the limitations which Mr. Mortimer has referred to, Mr. Fegan?

Mr. Fegan: Your Honor, I simply say that they are not applicable to this issue. He is referring to a regulation concerning how long a man is required to keep his records. *Mr. Irish is not charged here with violation of failing to keep records; he is charged with illegal conduct of churning accounts and charging people too much for securities. In connection with that, it is our contention that the Commission can go back to Mr. Irish's commencement in business; there is no statute of limitations.*

Hearing Examiner: *I can't agree with you on that.*

Mr. Fegan: Does the counsel have a statute of limitations they can cite?

Mr. Mortimer: I understand that there is no true civil statute of limitations as to the Commission's right to act against the broker dealers; there are, of course, statute of limitations growing out of customers' rights in civil law, but right now, I don't understand why the Securities Commission wants to question these very rules which are determinative of every hearing such as this. Why should a broker be burdened to go back fifteen or twenty years? To use Mr. Fegan's expression, they could go back to 1934, the day of the Act, and he would be responsible for his actions at that time, and also he would be responsible for proving that he was not guilty of the illegal conduct that they claim.

Hearing Examiner: I will do this; I would like to personally examine these ledger sheets, and I will hold their reception in abeyance until I have had an opportunity to do so.

May we pass on to something else?

Mr. Mortimer: May we go off the record?

Hearing Examiner: At this point, we will recess until two o'clock this afternoon.

(Whereupon, a recess was taken until 2:00 o'clock p.m.)

AFTER RECESS

Hearing Examiner: Let us come to order.

During the luncheon recess, I have examined the ledger sheets in these thirteen exhibits which the Com-

mission has offered in evidence, to some of which the Registrant, and I take it his son, have interposed objections. While the order, which instituted these proceedings and bears the date of March 19, 1959, says that the corporation's registration was withdrawn on April 18, 1945, and since the rule promulgated by the Commission, known as Rule X-17 A-4, indicates that broker dealers subject to Rule X-17 A-3 shall provide . . . preserve for not less than six years, the first two years in an easily accessible place, all record required to be made pursuant to Paragraph 1, 2, 3, 4, and 5 of Rule X-17 A-3, indicates that the Commission might desire to go into records which antedate a period more than six years prior the day this proceedings was instituted on March 19, 1955; nevertheless, Section II, Paragraph B of the said order of March 19, 1959, reads as follows: "B. During the period from approximately May 1, 1943, to approximately October 31, 1958, the corporation, the Registrant and Irish employed devices and schemes and artifices to defraud," and so forth. Since the start of this paragraph includes the corporation, *I feel that I must overrule the objections to the admissibility of these ledger sheets to which objection has been made. However, I wish to state I am impressed by the objections which have been raised to these ledger sheets which show transactions prior to six years which precede March 19, 1959, but due to the language employed in the order instituted in these proceedings, I feel that I should overrule the objection, and I now do so.* Division's Exhibits 1 through 13 inclusive are admitted in evidence, and

Messieurs Campbell and Mortimer are allowed an *exception* to this ruling on behalf of the Registrant and the Registrant's son.

Mr. Mortimer: We hereby except the ruling.

Hearing Examiner: I allowed you, but it is well enough for you to vocally except, Mr. Mortimer.

(Division's Exhibits Nos. 1 through 13 were received in evidence).

INTRODUCTION TO ARGUMENT

Appellants make claim that dilatory and neglectful handling of these private proceedings by the Respondent over an inordinate length of time is violative of due process. Respondent's own Hearing Examiner in his recommended decision of April 3, 1964, found it not in the *public interest* to revoke the broker-dealer registration of the Appellant and recommended that the proceedings be dismissed as the result of the staleness of the record and the delays in length of time the proceedings had been allotted (Tr. 1375-1395). Respondent had always allowed these hearings to be private (Tr. 2), not public, had never attempted to obtain an injunction against the alleged practices of the Appellants, had never instituted new proceedings against the Appellants, and had always allowed the Appellants to remain in business, conducting their business in a manner and mode always known to the Respondent because of the continuing surveillance by Respondent.

By Respondent's Order of August 27, 1965 (Tr. 1421-1430), Respondent summarily and permanently re-

voked the broker dealer registration of Appellant Russell L. Irish and found Appellant Russell Lawson Irish as the cause of the Order, effectively denying both Appellants their only livelihood. Said Order further summarily dismissed any allegations and claims of denial of due process, Respondent's failure to expeditiously conclude these hearings, and presumptions of Appellants' good conduct since the date of the hearings of September 1959. By so doing, Respondent violated its own Rules of Practice as well as the very intent of the Administrative Procedures Act, requiring that agency action shall not be unlawfully withheld or unreasonably delayed.

The severity of the Order, under the circumstances, is arbitrary, capricious, and an abuse of discretion, and has been promulgated without observance of required procedure and is unsupported by substantial evidence in this case.

The Respondent in its revocation order of August 27, 1965, inter alia, held that the Appellants were not entitled to any presumption of good conduct since the 1959 hearings when, in fact, Respondent acting through its identical individuals as a judging body under date of October 5, 1965, in review of an appeal by the Appellants herein of an order of the National Association of Securities Dealers, in Respondent's File No. 16-1A181, the Respondent reversed all penalties of the NASD against each of the Appellants and further in its opinion held "*Penalties imposed upon member excessive under all the circumstances, having due regard to the public interest, and reduced to censure, and assessments of*

costs reduced, and penalties and costs assessed against representative cancelled." (Emphasis ours.) The member is Appellant Russell L. Irish and the representative Appellant Russell Lawson Irish. The initial filing of the complaint in the NASD proceedings was October 16, 1962. The NASD hearings covered evidence and exhibits appertaining to transactions of the Appellants from at least 1956 to 1962, both time periods prior to the September, 1959 hearings and subsequent thereof. These NASD proceedings are separate and not a part of the 1955 NASD action which was closed at that time.

ARGUMENT

Petitioners Have Been Denied Due Process of Law

Private hearings were held in September, 1959 (Tr. 1-469), and the last deposition in this cause was held on April 5, 1961 (Tr. 578-592). Thereafter the Respondent's Division of Trading and Markets, the moving and prosecuting party herein, did nothing further to conclude these proceedings. The Respondents have now invoked the harshest penalties available to them, complete revocation of registration as a broker-dealer after allowing these proceedings to lie dormant for many years. The very essence of the conclusion of these proceedings and the resultant penalties have been an effective denial of due process to Russell L. Irish and Russell Lawson Irish, after this inordinate administrative delay, not contributed to by the Appellants. The affidavits on file well indicate the efforts on behalf of Appellants to conclude these proceedings until suddenly, arbitrarily,

and capriciously, the Respondent chose to close the proceedings (Tr. 1087-1099; 1127-1158).

The penalties meted out are so remote in time from the alleged violations as to constitute a taking of Appellant's property and rights without due process. The very essence of justice has been denied when proceedings lie dormant over an interminable period of time, and the prosecutor then elects at his caprice to obtain penalties on such long neglected charges. *Smith v. Illinois Bell Telephone Company*, 270 U.S. 587, 46 S. Ct. 407, 70 L. Ed. 747; *Deering-Milliken v. Johnston*, 295 F.2d 856; *Swift and Company v. U.S.*, 308 F.2d 849; *Amos Treat and Company v. Securities and Exchange Commission*, 306 F.2d 260, 113 U.S. App. D.C. 100; *Kessler v. FCC*, 326 F.2d 673, 117 U.S. App. D.C. 130.

It is well known that a person's business is a property right. *Truax v. Corrigan*, 1921, 22 S.Ct. 124, 257 U.S. 312, 66 L. Ed. 254; see also *Lasdon v. Hallihan*, 1941, 36 N.E.2d 227; *Morland Theaters Corporation v. Portland Moving Pictures Machine Operators Protective Union*, 12 P.2d 333, 140 Ore. 35.

In addition, due process of law guarantees every person his day in court and requires orderly proceedings in accordance with generally established rules not violative of fundamental rights. The Appellants have not been accorded orderly process and have been granted only inordinate delays. See *Rosenblum v. Rosenblum*, 42 N.Y.S.2d 626, 181 Misc. 78.

It must be noted that the Respondent's own hearing examiner in his decision of October 23, 1963, refused to reconvene these hearings upon the request of the Respondent, stated:

"Furthermore, the concept of fairness and due process require that proceedings such as these be prosecuted expeditiously and the hearing examiner is of the opinion that it will be unfair to the registrant (Appellant) and Russell Lawson Irish and the alleged 'cause' to resurrect this case after it has been in such inactive and dormant condition for so long." (Tr. 1082-1083.)

The hearing examiner in his Recommended Decision of April 13, 1964, further stated that:

"In view of the long delay and spasmodic prosecuting of this case, the hearing examiner is of the opinion that it cannot be seriously argued that that public interest requires the revocation of Mr. Irish's registration. In his judgment, these proceedings should be dismissed." (Tr. 1375-1395.)

Also see *Howard F. Hansell, Jr.*, 31 SEC. 393; *Herbert A. Mendell dba Herbert A. Mendell Company*, 31 SEC 491; and *Wesreb Oil Company*, (Securities Act Release No. 4647) September 30, 1963.

The Hearing Examiner's Recommended Decision stated that the record was silent as to how the Appellants have been conducting their business since then (the 1959 hearing). The Respondent in its decision reversing the Recommended Decision of the Hearing Examiner, summarily dismissed the contention that the Appellants were entitled to a presumption of good conduct.

It is difficult to conceive under any rationale of due process, how the Respondent in its Order of August 27, 1965 (Tr. 1421-1430), could hold the Appellants were not entitled to any presumption of good conduct. The Respondent callously and with cynical disregard

of the rights of the Appellants and with a zeal that hardly can be commended, ignored that presently pending before it at the very time of its Order of August 27, 1965 (Tr. 1421-1430), was an appeal by the Appellants from a decision of the National Association of Security Dealers which covered the time period of 1956 to 1962. Respondent by its Order of October 5, 1965 and through Respondent's *identical* commissioners that promulgated the August 27, 1965 Order, reviewed the disciplinary proceedings of the NASD, and held that the penalties imposed on the Appellants by the NASD were excessive under all the circumstances, having due regard to the "*public interest*," and found that there should be no penalties other than censure of Appellant Russell L. Irish and no penalties whatsoever on Appellant Russell Lawson Irish, and that fines or costs be dismissed except for the nominal sum of \$500 costs applied to Appellant Russell L. Irish. The Respondent further held that "under the circumstances, the sanctions and costs assessed with respect to . . . member's son (Russell Lawson Irish) must be cancelled."

Only five weeks after the Respondent's Order of revocation of August 27, 1965, the Respondent, by and through its same commissioners, held that the Appellants had not conducted themselves improperly. It is further interesting to note that the initial proceedings of the NASD dismissed those charges.

The Respondent has ignored in a manner grossly arbitrary and capricious judicial notice or information that would of itself deny the Respondent's finding of lack of presumption of good conduct.

If it were in the public interest to revoke the registration of Appellants Russell L. Irish and Russell Lawson Irish, the alleged cause of such revocation, why then were these proceedings always allowed to remain private by the Respondent, even after the Appellants had urged that they could be made public, at one of the many times the Appellants urged that these proceedings be closed? See letter of Appellants' counsel of August 28, 1962, to Respondent, which states in part:

"In addition, Mr. Irish has no objection to the proceedings being made public, in fact considers it a desirable feature, and requests that any proceedings hence forth be made public." (Tr. 1127-1158.)

as to cause complete denial of their opportunity to . . . engage in business as a broker-dealer, why, if the public interest was so jeopardized, why were so many years allowed to go by without seeking injunctive relief or at least making these hearings public in order to protect "the public interest"?

Respondent's Division of Trading and Markets Has Been Guilty of Laches in its Handling of the Proceedings Herein and Violative of the Constitutional Rights of the Appellants.

The Division of Trading and Markets in the past has attempted to assert that laches may not be asserted against governmental actions. Laches can be asserted against governmental action *which is void or not right*, although estoppel and laches cannot be asserted to defeat an existing right of the United States. Cases carefully distinguish circumstances under which the government has not received any rights or where its

actions are void and the rule is carefully so limited. *Guaranty Trust v. U. S.*, 304 U.S. 126, 135, 141 (1937); *Utah Power and Light v. U. S.*, 243 U.S. 389, 409 (1917); *Causey v. U. S.*, 240 U.S. 399, 402; *Chesapeake Canal Company v. U. S.*, 250 U.S., 123, 126 (1919). As in this case the United States has never obtained the right to violate its own Constitution. Unreasonable delay arising through a violation of due process is a valid limitation upon the acts of government in this case. *Smith v. Illinois Belle Telephone Company*, 270 U.S. 587; *Steen v. Los Angeles*, 31 Cal.2d 542, 190 P.2d 937.

The U. S. Supreme Court has not categorically rejected the imposition of the doctrine of laches against the government, even where the government is protecting the *public interest* if a violation of individual constitutional rights might be threatened. *Costello v. U. S.*, 365 U.S. 265, 281-4 (1960) (applying the law of *U. S. v. Ali*, 7 F.2d 728; *Johannessen v. U. S.*, 225 U.S. 227.)

The requirement of laches by the government is present. The case authority against holding laches on the part of the government applies in those cases when dilatory conduct of the party attempting to assert laches has caused delay. See *Major v. Shaver*, 187 F.2d 211; *Northern Pacific v. Boyd*, 220 U.S. 840, 842; *Smith v. Illinois Bell Telephone Company*, *supra*, the Supreme Court gave summary treatment of the government's assertion that new proceedings were required. In the instant case of the Appellants, Respondent attempts to assert the necessity of investigating new matter as an excuse for delaying pending proceedings.

The Respondent continued further investigations after the hearings of September, 1959, and never has again ever brought any further proceedings, whether private, public, or by injunctive claim, against the Appellants.

That Respondent's Division of Trading and Markets is in Violation of Respondent's Rules of Practice 201.16(e), and also in Failure to Provide Expeditious Proceedings Under Respondent's Rules of Practice 201.13 and 5 USCA 1009(e).

Securities and Exchange Commission Rules 201.13 and 201.16 set time limits of 30 and 45 days for either continuation of hearings or filing of findings. Being valid rules of regulation by the Respondent, these are binding upon the Respondent. See *Accardi v. Shaughnessy*, 347 U.S. 260, 267; *Service v. Dulles*, 354 U.S. 363; *Sangamon Valley Television v. U.S.*, 269 F.2d 221; *Jefferson Amusement Company v. FCC*, 226 F.2d 277; *American Broadcasting v. FCC*, 179 F.2d 437; *Sheridan-Wyoming Coal v. Krug*, 172 F.2d 282.

The Respondent's Division of Trading and Markets cannot now assert some other construction of the Commission rules due to present circumstances which would change their clear intent. *U. S. v. Missouri-Pacific Railroad Company*, 278 U.S. 269. (The Court held that administrative usage must be uniform and of long standing in order to allow administrative construction to vary unambiguous regulatory provisions.)

The Respondent has failed to follow the Administrative Procedures Act relative to delay. Under 5 USCA 1009(e) the Courts have held that even if the general procedural rule of an agency is otherwise, and does not

provide a time limitation to guide the Hearing Examiner, statutes cited will control. *Deering-Milliken v. Johnson*, supra; see again 5 USCA 1009(e), in part set forth as follows:

“So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, and abusive of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of §1006 and 1007 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party and due account shall be taken of the rule of prejudicial error.”

The Supreme Court has rejected any narrow interpretation of the effect of the Administrative Procedures Act. *Riss and Company v. U. S.*, 341 U.S. 907; *Cates v. Haderlein*, 342 U.S. 804.

The policy of the Administrative Procedures Act has already been adopted by the Commission in the case of *In re Engineering Public Service*, 10 SEC 327. Its spirit of fairness was followed by the Commission even

earlier. *In re Consumer Power*, 6 SEC 444. Unreasonable delay easily gives rise to violation of due process of law as in the instant appeal. It is this high standard which is the policy of the Administrative Procedures Act. Swartz, "A Decade of Administrative Law: 1942-1951," 51 Mich. L. Rev. 775, 791-3 (1950).⁷ This is a part of Securities and Exchange jurisprudential traditional.

The recommended decision of the Hearing Examiner of April 3, 1964 (Tr. 1375-1395), in effect held the Respondent guilty of laches and failure to extend due process to the Appellants.

Section 201.13 of the Respondent's own rules states as follows:

"...It is the policy of the Commission that such adjournment shall be for not more than 30 days and in no event shall the Hearing Officer order an adjournment for a period in excess of 45 days."
(Emphasis ours.)

This very rule strikes the heart of this issue. The commission's staff proposed on October 14, 1963 (Tr. 1077-1081), to reconvene these proceedings which had been closed four years and one month after their adjournment. These proceedings were closed subject only to the taking of several depositions, of which the last was taken on April 5, 1961.

The instant proceedings covered a period from 1941 to the time of the 1959 hearing, and included records not required to be held by the very rules and regulations of the Securities and Exchange Commission. The records and exhibits, at this point of time, are rendered meaningless without the possibility of review of original

records, many of which were no longer available to the Appellants. Section 17(a) of the Securities and Exchange Act of 1934, supplemented by Rules X-17(a)-3 and X-17(a)-4), along with other definitive rules subject of this action, state that the Appellants are not required to hold blotters and ledgers, for example, for more than six years and that certain other financial records need be kept or preserved for only three years. No records are required to be held for more than six years. The scope of these proceedings was from 1941 to the date of the hearings.

One of the prime reasons for appointing the president's Conference on Administrative Procedure in 1953 was to study ways to eliminate unnecessary delay. The Conference recommended:

"That every agency consider unnecessary delay, expense and volume of records and adjudicatory proceedings to be detrimental to the public interest."

The Conference called this declaration the underlying philosophical declaration by the Conference. See *Davis on Administrative Law*, §8108, p. 550.

The federal courts have viewed the lack of due process because of administrative irregularities and delay in such proceedings with sufficient gravity that the courts have held there is no absolute requirement that a party even exhaust his administrative remedies before coming into court in such cases. *Adler v. U. S.*, Ct. of Cl., 146 F. Supp. 956.

Win or lose, protracted proceedings usually effectively destroy any business. See *FTC v. Evis Manufacturing Company*, (9th Circ.) 287 F.2d 831.

Securities and Exchange Regulation 201.19 further emphasizes the requirement of expeditious proceedings in broker-dealer revocations—another of the Respondent's regulations that Respondent also chose to bypass.

Reg. §201.19:

“In any proceeding pursuant to section 15(b) of the Securities Exchange Act of 1934 on the question of suspension of registration of a broker or dealer pending final determination whether such registration shall be revoked, the following time shall be applicable, unless otherwise ordered by the Commission, in lieu of the time limits prescribed by other provisions of these rules:

“(a) *Proposed Findings and Briefs.* Proposed findings and conclusions and briefs in support thereof may be filed within three days after the close of the hearing.

“(b) *Service of Record; Filing of Decision.* In Proceedings in which an initial decision by a hearing officer is to be prepared, the record in the proceedings shall, promptly after the time for filing proposed findings and conclusions and briefs in support thereof, be served by the Records Officer upon the hearing officer. The initial decision shall be filed with the secretary within five days after such service.

“(c) *Petition for Review.* Any petition for review must be filed within three days after receipt of the initial decision.

“(d) *Briefs.* Briefs in support of a petition for review, or in support of or in opposition to any portion of an initial decision, may be served and filed within five days after receipt of notice that the Commission has ordered review of the initial decision. Reply briefs may be served and filed within five days of receipt of an original brief.

“(e) No Review by the Commission on Its Own Initiative. The provisions of Rule 17(c) of these rules shall not be applicable to proceedings to which this rule applies.”

The Findings of Fact by the Respondent are not Supported by the Evidence.

The Respondent revived long-dormant hearings which very conclusion and appeal have caused Appellants extreme financial hardship and difficulty of preparation.

Stale records have caused these proceedings to be totally deprived of their vitality and rendered these matters to be substantially unfair to appellants so as to be procedurally irregular to the prejudice of the Appellants' appeal. The record of this cause on appeal indicates the highly technical methods of accounting used by the Respondent with a record that included testimony and exhibits appertaining in time as much as 18 years prior in time to the date of the 1959 hearings, well beyond the maximum three and six years required by the Respondent's own rules for holding books and records by the Appellants. Respondent's schedules submitted in this cause were so distorted as to give an untrue and unrealistic picture of trading activities and gains and losses.

Testimony shows that the Appellants' customers were aware of the investigation and the proceedings of Respondent. No customers ever launched a complaint nor had the Appellants lost any of their customers. These were well-informed investors not impressed by government allegations. The customers controlled and

used the Appellants as their agents for execution of their purchases and sales as dictated by the customer's own personal and business considerations. The Appellants never handled discretionary accounts; they were not registered as investment brokers and there never was any allegation or testimony of secret profits (Tr. 1-469). It was noted in *Behel Johnsen*, 26 SEC 163, a broker-dealer was churning *discretionary* accounts and obtaining *secret* profits by inducing customers to engage in excessive trading. It is well recognized that customers may initiate their own trading orders for their own purposes. *In re Thompson & McKinnon*, 1953, 35 SEC 451.

Contrary to the findings of Respondent, Appellants' testimony did disclose that the break-point costs were always disclosed to the customers and the Appellants even furnished confirmations, not required by law, which stated that the costs of any exchange of securities should always be weighed by the customer. Customers testified they were always advised of break points and even their attention was called to the statements on the confirmations (Tr. 1-469; 874-916; 917-918). Customers further testified they were always furnished a prospectus which was discussed, including the break points, at the time of purchase or conversion of funds. Appellants never obtained secret profits from their customers. Customers of Appellants testified to their knowledge of financial periodicals and their reliance upon their own judgments in the purchasing and sale of shares of mutual funds. The only instance of the failure to obtain a break point in the in-

stant cause was the result of an error caused by the mutual fund in its offices in New York City (Tr. 919-334; 935-937). There were no allegations before or subsequent to that time of any other such alleged violation.

The Appellants were not shown to have used manipulative, secret, or fraudulent practices nor did they fail to represent correctly and at all times all material information to the customers. There is no testimony that meets the test of reasonable proof that shows the Appellants failed to disclose all material circumstances and information fully and completely to their customers.

Rules of evidence require that wilful violations of fraud sections of the statutes and regulations must be supported by substantial evidence in the record, which is here notably lacking. See *R. H. Johnson and Company*, 198 F.2d 690, which included secret profits, from unsophisticated investors (elderly widow, disabled veteran, house painter with little education, steam fitter, etc.).

It is interesting that the Hearing Examiner in his Recommended Decision of April 3, 1964, noted that:

“When the hearings in these proceedings were closed on September 24, 1959, under the conditions hereinbefore mentioned, the Hearing Examiner had the impression that the Division’s case against the Respondents was, indeed, weak.

“...The long delay in bringing this case to the attention of the Hearing Examiner leaves him bereft of the opportunity of testing and passing upon the credibility of the various witnesses.” (Tr. 1375-1395.)

Although the Hearing Examiner held that there was substantial evidence to support a recommended decision, he paid note in his Recommended Decision of April 3, 1964, that the Registrants' (Appellants') counsel strongly objected to the admission of exhibits on the grounds that the records older than six years were irrelevant, citing Respondent's Rule 17(a)-3 and Rule 17(a)-4. The Hearing Examiner went on to state:

"While the Hearing Examiner had misgivings as to the soundness of his action which he expressed at the time (Tr. 29-30), he overruled the objections and admitted Division's exhibits 1 through 13, inclusive, in evidence. *These misgivings still exist.*" (Tr. 1373-1395.) (Emphasis ours.)

As a result, a substantial portion of the record of the September, 1959 hearing was evidence that was improperly admitted and was irrelevant by its very lack of relationship in time to the proceedings and scope of the hearing. It is obvious that a substantial portion of this case came from these improperly admitted records. Without this improperly admitted evidence, which is the greatest bulk of the evidence admitted in these proceedings, it cannot reasonably be argued by Respondent that there was substantial evidence, much less any real evidence, to support the findings and Order of the Respondent of August 27, 1965, revoking the Appellant's broker-dealer registration. The Hearing Examiner had already called the case of the Respondent "indeed weak," and this included the questionable admission of evidence to which the Hearing Examiner stated he had "misgivings" as to its admission, and that those "misgivings" still existed at the time of his Recom-

mended Decision of April 3, 1964.

During the proceedings subject of this appeal, one request for inspection of the Appellants' books was made on May 27, 1959. At that time there was no designation of what specific records and accounts were to be produced but only a "shot gun" request of inspection of records. No limitation was placed upon this request for inspection and compliance therefor was impossible. The action of the Respondent in the request for inspection, its manner of making and scope of demand, was arbitrary and unreasonable and incapable of conformance on the part of the Registrant (Tr. 29-40). See *SEC v. Bourbon Sales Corp.*, 47 Fed. Sup. 70. The Fourth Amendment to the Constitution is available to protect against too much indefiniteness or breadth in the things required to be particularly described. *SEC v. Vacuum Can Company*, 157 F.2d 530. This is just a further example of the denial of due process replete in these proceedings since their very inception.

It has been long held that statutes relating to production of books and records by parties to pending suits do not permit an unbridled investigation or "fishing expedition" into an adversary's books and records and statutes must recognize the constitutional declaration that the people shall be secure from unreasonable searches and seizures and to ignore such constitutional privileges is a denial of due process. *State ex rel St. Louis Union Trust Company v. Sartorus*, 171 S.W.2d 569; 351 Mo. 111.

Substantial portions of the evidence introduced by

the Respondent in this case covered periods of time remote from the proceedings making it impossible to have orderly proceedings and included much material so far beyond the necessity of the case as to be an arbitrary exercise of governmental power. See *Farmers Educational and Co-op Union v. Circuit Court of Charles Mix County*, 1950, 40 N.W.2d 402.

It is strongly urged that the greatest portion of the evidence adduced in these proceedings subject to this appeal are irrelevant and immaterial and not properly before the Respondent nor before this Court on appeal. Without this evidence, there can be little doubt that there was not substantial evidence to support the Respondent's Order.

CONCLUSION

Appellants are the victims of belated prosecution, unreasonable delay of administrative action, denial of due process, and the admission of evidence unrelated in time and irrelevant to the subject proceedings. The Respondent has flagrantly violated its own rules of practice and procedure that would ensure orderly and expeditious proceedings. Respondent has even gone to the extreme of holding that the Appellants were not entitled to a presumption of good conduct. Then Respondent through its identical commissioners five weeks later effectively held that the Appellants' behavior had in fact been good. The Appellants are entitled to judicial notice being taken of Respondent's decision of October 5, 1965, which held the Appellants blameless of misconduct in the transaction of their securities

business subsequent to the hearings of September, 1959.

The greatest volume of evidence in the subject proceedings is before the Respondent improperly, having been erroneously admitted by the Hearing Examiner, who in his own Recommended Decision of April 3, 1964, questioned the very soundness of his own ruling in ever having admitted this evidence which comprised the great bulk of the evidence before the Respondent. He described the case of Respondent as "weak" at best.

Public interest has been described by the Respondent as necessitating the revocation of the Appellants' registration and the deprivation of the Appellants' livelihood. This can only be construed as an arbitrary and capricious decision inasmuch as these proceedings and investigations were instituted in 1957, culminating with the hearing of 1959, always on a private basis. All during that time, if the "public interest" had so required, these proceedings would have been made public at the very least and, if the "public interest" was endangered, the Respondent would have attempted to seek an injunction against the Appellants, preventing them from engaging in alleged practices belatedly found by the Respondent to endanger the "public interest" to such extent as to cause revocation.

These proceedings are unique in the flagrant and continued abuse of the constitutional rights of the Appellants through the dilatory and questionable tactics of the Respondent, by the admission of evidence well beyond the requirements of the Respondent's own rules to have such information accessible for review and by the Respondent's callously holding in its opinion

that the Appellants are not to be accorded any presumption of good conduct (when before that same body was presently pending an appeal from the NASD, which five weeks later the identical Commissioners of the Respondent decided in favor of the Appellants, holding that they were not guilty of the charge of the NASD and that it was not in the "public interest" to sustain the penalties).

The repugnancy of the two decisions, one finding "public interest" required revocation, the other decision finding "public interest" required no penalties, disclose the capricious and arbitrary nature of the Respondent's Order of August 27, 1965.

As a result Appellants have been denied due process by the caprice of the Respondent in a manner which has not only violated the constitutional rights of the Appellants but violated the Respondent's own rules of practice and procedure, and violated the very language and intent of the Administrative Procedures Act. The Respondent has been dilatory, capricious, arbitrary, and unjust in its handling of the very economic existence of the Appellants. The Respondent by its Order of August 27, 1965, totally deprived the Appellants of their only means of livelihood and their sole vocation in deprivation of the constitutional rights of the Appellants herein.

The Order of the Securities and Exchange Commission, the Respondent herein, of August 27, 1965, revoking the broker-dealer registration of Russell L. Irish and finding Russell Lawson Irish as cause of that Order,

should be reversed and set aside.

Respectfully submitted,

T. DAN MORTIMER
OF REAUGH, HART, ALLISON,
MORTIMER & PRESCOTT

Attorneys for Petitioner

1100 IBM Building
Seattle, Washington

Appendix

1
APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
1	Photocopies of ledger sheets of account of Harry A. Boger for years 1943 thru 1957.	593-603
2	Photocopies of ledger sheets of Account of Harry N. Boger for years 1947 thru 1957.	604-611
3	photocopies of ledger sheets of account of Maurice D. Prince for years 1950 thru 1956.	612-619
4	Photocopies of ledger sheets of account of Louis E. Alboucq for years 1950 thru 1956.	620-625
5	Photocopies of ledger sheets of account of Mrs. Therese W. Benedict for years 1949-1956.	626-632
6	Photocopies of ledger sheets of account of Mr. and Mrs. Evan I. Evans for years 1943 thru 1957.	633-651
7	Photocopies of ledger sheets of account of Dr. Milo Harris for years 1943 thru 1957.	652-663
8	Photocopies of ledger sheets of account of Johnnie R. Hughes for years 1951 thru 1956.	664-666
9	Photocopies of ledger sheets of account of Jacob C. Keller for years 1948 thru 1956.	667-673
10	Photocopies of ledger sheets of account of O. George Wagnild for years 1949 thru 1956.	674-682
11	Photocopies of ledger sheets of account of August I. Pfeifer for years 1944 thru 1955.	683-687

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
12	Photocopies of ledger sheets of account of Robert F. and Jennie Brauer for years 1943 thru 1957.	688-704
13	Photocopies of ledger sheets of account of Fred H. and Elizabeth A. Sinkler for years 1943 thru 1955.	705-712
14 to 17 (Inclusive)	Ledgers, Journals and Account Books of Russell L. Irish Investments admitted into evidence with the understanding that relevant portions thereof, if needed, could be photocopied, so that the entire records would not have to be kept.	
18	Copy of letter dated January 7, 1954 from R. L. Irish to Mrs. Therese W. Benedict advising that her Steel Shares and Republic Investors had been liquidated and moved over into the three National Securities Series.	713
19	Typewritten ledger sheets for the period June 30, 1945 thru July 31, 1953.	714-717
20	Letters dated January 23 and 29 and November 12, 1958 from Russell L. Irish to the Commission submitting information regarding the Future Planning Accounts of six customers.	718-721

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
21	Photocopies of ledger sheets entitled "Harry A. Boger — Records of Purchases and Sales of Securities through Russell L. Irish Investments" for period October 22, 1943 thru July 20, 1956.	722-726
22	Photocopies of ledger sheets entitled "Harry A. Boger, Results of Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period October 22, 1943 thru July 20, 1956.	727-728
23	Photocopies of ledger sheets entitled "Harry N. Boger — Record of Purchases and Sales of Securities through Russell L. Irish Investments" for period June 4, 1947 thru September 4, 1956.	729-732
24	Photocopies of four pages of ledger sheets entitled "Harry N. Boger, Results of Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for dates June 4, 1947 thru September 4, 1956.	733-736
25	Photocopies of ledger sheets entitled "Maurice D. Prince — Record of Purchases and Sales of Securities through Russell L. Irish Investments" for period December 6, 1950 thru August 3, 1956.	737-738

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
26	Photocopy of ledger sheet entitled "Maurice D. Prince — Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period December 6, 1950 thru July 31, 1956.	739
27	Photocopies of ledger sheets entitled "Louis E. Alboucq — Record of Purchases and Sales of Securities through Russell L. Irish Investments" for period January 27, 1950 thru October 2, 1956.	740-741
28	Photocopy of ledger sheet entitled "Louis E. Alboucq — Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period December 27, 1950 thru October 2, 1956.	742
29	Photocopies of ledger sheets entitled "Mrs. Therese W. Benedict — Record of Purchases and Sales of Securities through Russell L. Irish Investments" for period May 4, 1949 thru October 31, 1956.	743-744
30	Photocopy of ledger sheet entitled "Mrs. Therese W. Benedict — Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period May 4, 1949 thru July 11, 1956.	745'

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
31	Photocopies of ledger sheets entitled "Evan I. Evans — Record of Purchases and Sales of Securities through Russell L. Irish Investments" for period December 10, 1943 thru December 31, 1956.	746-755
32	Photocopies of ledger sheets entitled "Evan I. Evans — Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period December 10, 1943 thru October 2, 1956.	756-759
33	Photocopies of ledger sheets entitled "Dr. Milo Harris — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period May 21, 1943 thru September 20, 1956.	760-765
34	Photocopies of ledger sheets entitled "Dr. Milo Harris — Purchases & Sales of Mutual Fund Shares through Russell L. Irish Investments" for period May 21, 1943 thru September 20, 1956,	766-767
35	Photocopies of ledger sheets entitled "Johnnie E. Hughes — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period October 24, 1951 thru October 2, 1956.	768-769

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
36	Photocopy of ledger sheet entitled "Johnnie R. Hughes — Results in Account as Handled from Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period October 24, 1951 thru October 2, 1956.	770
37	Photocopies of ledger sheets entitled "Jacob C. Keller — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period September 20, 1948 thru October 2, 1956.	771-774
38	Photocopies of ledger sheets entitled "Jacob C. Keller — Results in Account as Handled from Purchases and Sales of Mutual Shares through Russell L. Irish Investments" for period September 30, 1948 thru October 2, 1956.	775-776
39	Photocopies of ledger sheets entitled "C. George Wagnild — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period October 5, 1949 thru October 2, 1956.	777-780
40	Photocopies of ledger sheets entitled "O. George Wagnild — Results in Account as Handled through Russell L. Irish Investments" for period October 5, 1949.	781-782

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
41	Photocopies of ledger sheets entitled "August I. Pfeifer — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period February 1, 1944 thru October 2, 1956.	783-786
42	Photocopy of ledger sheet entitled "August I. Pfeifer —Results in Account with Irish Firm" for period February 1, 1944 thru October 2, 1956.	787
43	Photocopies of ledger sheets entitled "Robert F. & Jennie Brauer — Record of Purchases & Sales of Securities through Russell L. Irish Investments" for period December 22, 1943 thru October 2, 1956.	788-795
44	Photocopies of ledger sheets entitled "Robert F. Brauer — Account as Handled from December 22, 1943 to December 31, 1956 through Russell L. Irish Investments."	796-798
45	Photocopies of ledger sheets entitled "Fred H. Senkler — Purchases and Sales of Mutual Fund Shares through Russell L. Irish Investments" for period October 26, 1943 thru September 28, 1954.	799-800

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
46	Customer's ledger sheets of Fred H. Senkler, for period October 26, 1943 thru January 1, 1955. _____	801-802
47	Photocopy of ledger sheet entitled "General Analysis Schedule Showing the Results Obtained by Certain Customers as a Result of Their Dealings in Mutual Fund Shares through Russell L. Irish Investments, Spokane, Washington." _____	803
48	Photocopies of ledger sheets entitled "Harry A. Boger — Account with Russell L. Irish Investments — Cash Receipts and Disbursements in his account with Russell L. Irish Investments" for period October 10, 1944 thru July 31, 1956 and "Harry A. Boger, Computation of Average Investment with Russell L. Irish Investments" for 1944, 1947, 1950, 1953 and 1956. _____	804-806
49	Photocopies of ledger sheets entitled "Harry N. Boger — Cash Receipts & Disbursements in his account with Russell L. Irish Investments" for June 4, 1947 thru October, 1956 and "Harry N. Boger — Computation of Average Investments in his account with Russell L. Irish Investments" for 1947, 1950, 1953 and 1956. _____	807-809

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
50	Photocopies of ledger sheets entitled "Maurice D. Prince — Record of Receipts and Disbursements through Account with Russell L. Irish Investments" for period December 7, 1950 thru September 26, 1956 and "Maurice D. Prince, December 6, 1950 to March 9, 1955, Computation of Average Investments in account with Russell L. Irish Investments"; same for March 9, 1955, thru December 31, 1956. ..	810-813
51	Photocopies of ledger sheets entitled "Louis E. Alboucq — Record of Cash Receipts & Disbursements from January 3, 1951 to September 30, 1954 through account with Russell L. Irish Investments" and "Louis E. Alboucq — Computation of Investments for December 30, 1950 thru September 30, 1954 in account with Russell L. Irish Investments"; same for December 3, 1950 thru December 31, 1956.	814-817
52	Photocopies of ledger sheets entitled "Mrs. Therese W. Benedict — Record of Cash Receipts and Disbursements in Account with Russell L. Irish Investments" for period May 5, 1949 thru November 11, 1956 and "Mrs. Therese W. Benedict — Computation of Average Investments in account with Russell L. Irish Investments" for 1949, 1952 and 1955.	818-819

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
53	Photocopies of ledger sheets entitled "Evan I. Evans — Cash Receipts and Disbursements, January 31, 1947 to September 30, 1954 in Account with Russell L. Irish Investments" and "Evan I. Evans — Computation of Average Investment in Account with Russell L. Irish Investments, January 31, 1947 to September 30, 1954."	820-822
54	Photocopies of ledger sheets entitled "Dr. Milo Harris — Record of Cash Receipts & Disbursements through Account with Russell L. Irish Investments" for period May 13, 1943 thru October 2, 1956 and "Dr. Milo Harris — Computation of Average Investments in Account with Russell L. Irish Investments" for 1943, 1946, 1949, 1952.	823-825
55	Photocopies of ledger sheets entitled "Johnnie R. Hughes — Record of Cash Receipts & Disbursements through Russell L. Irish Investments" for period October 24, 1951 thru October 4, 1956 and "Johnnie R. Hughes — Computation of Average Investments in Account with Russell L. Irish Investments" for 1951 and 1954.	826-827

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
56	Photocopies of ledger sheets entitled "Jacob C. Keller — Record of Receipts & Disbursements through Account with Russell L. Irish Investments" for period October 6, 1948 thru October 2, 1956 and "Jacob C. Keller — Computation of Average Investment in account with Russell L. Irish Investments" for 1948, 1951 and 1954.	828-830
57	Photocopies of ledger sheets entitled "O. George Wagnild — Record of Receipts & Disbursements through his Account with Russell L. Irish Investments" for period October 5, 1949 thru October 8, 1956, and ledger sheet entitled "O. George Wagnild — Computation of Turnover Rates." ..	831-833
58	Photocopies of ledger sheets entitled "August I. Pfeifer — Record of Cash Receipts and Disbursements in Account with Russell L. Irish Investment for March 18, 1948 to December 31, 1956" and "August I. Pfeifer, March 18, 1948 to December 31, 1956, Computation of Average Investments in Account with Russel L. Irish Investments."	834-835

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
59	Ledger sheet entitled "Mrs. Therese W. Benedict — Comparison of Results of Reinvestment Recommended for Tax Purposes and Increased Income as of December 31, 1954, 1955 and 1956."	836
60	Photocopies of ledger sheets taken from Division's Exhibits 14A, 14B and 17.	837-860
61	Schedules prepared September 23, 1959 by A. E. Wetzel and D. K. Halbakren from Daily Journal of Russell L. Irish Investments, and photocopies prepared from the General Ledger and Customers' Ledger of Russell L. Irish Investments.	861-872
62	Letter dated December 30, 1957 from Russell L. Irish to the Commission advising that photocopies of the customer's accounts left with Russell L. Irish by the Commission were found to be substantially correct.	873

*Registrant's
Exhibit No.*

- 1 (Reserved in case registrant decided to file an analysis of accounts.)

APPENDIX

<i>Division's Exhibit No.</i>	<i>Description</i>	<i>Page No.</i>
2	Schedules headed "Securities, No. of Shares, Data Acquired, Cost Price per Unit and also money, the date Sold, Sales Price in unit and money, given to customers by Russell L. Irish Investments annually." -----	874-916
3	Invoice from the Inland-Pacific Stamp Works dated November 11, 1955 to Russell L. Irish for seven on line stamp with attached copy confirmation. -----	917-918
4	8 Confirmations of trade, together with 8 copies of said confirmations dated February 18, 1954 from Distributors Group, Incorporated to Russell L. Irish Investments.	919-934
5	Copy of letter dated February 25, 1954 (unsigned) to Distributors Group, Inc. advising that a check for \$4,467.25 is enclosed which is in payment of the balance due on purchases itemized.	935-937
6	Telegram, dated August 25, 1959 to Mr. Irish from Miles Burgess.	

(Identification
only)

II. Documents in the Nature of Pleadings and Procedural Rulings Thereon

	<i>Page</i>
Application on Form 3-M for registration of broker or dealer filed with the Commission August 15, 1941 by Russell L. Irish.	938-948
Supplemental statement on Form 6-M filed September 6, 1941 to application filed August 15, 1941.	949-951
Supplemental statement on Form 6-M filed September 15, 1941 to application filed August 15, 1941.	952-953
Supplemental statement on Form 6-M filed September 30, 1941 to application filed August 15, 1941.	954-955
Supplemental statement on Form 6-M filed November 10, 1941 to application filed August 15, 1941.	956-957
Supplemental statement on Form 6-M filed March 7, 1942 by Russell L. Irish Investments, Corporation (formerly Russell L. Irish) to application filed August 15, 1941.	958-959
Application on Form 3-M for registration of broker or dealer filed April 13, 1942 by Russell L. Irish Investments, Corporation.	960-971
Supplemental statement on Form 6-M filed May 2, 1942 to application filed April 13, 1942. ...	972-973
Application on Form 3-M for registration of broker or dealer filed February 13, 1945 by Russell L. Irish, dba Russell L. Irish, Investments.	974-984
Supplemental statement on Form 6-M filed April 2, 1945 to application filed February 13, 1945.	985-986

No. 20,472

**In the United States Court of Appeals
for the Ninth Circuit**

**RUSSELL L. IRISH, d/b/a RUSSELL L. IRISH INVESTMENTS,
and RUSSELL LAWSON IRISH, PETITIONERS,**

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT.

**BRIEF FOR RESPONDENT SECURITIES AND
EXCHANGE COMMISSION**

DAVID FERBER,

Solicitor.

EDWARD B. WAGNER,

Special Counsel.

MARTIN D. NEWMAN,

Attorney.

*Securities and Exchange Commission,
Washington, D.C. 20549.*

FILED

JUL 21 1966

WM. B. LUCK, CLERK

INDEX

	Page
Citations	ii
Jurisdictional statement.....	1
Counterstatement of the case.....	2
<i>Churning</i>	3
<i>Failure to disclose minimum break points</i>	7
<i>Sales at prices above offering price</i>	8
<i>The delay in the proceeding</i>	9
Summary of argument.....	14
Argument:	
I. The Commission properly found that petitioners had violated the antifraud provisions of the securities laws and its decision is supported by substantial evidence	15
A. <i>Excessive trading in customers' accounts</i>	15
B. <i>Sales below break points</i>	21
C. <i>Sales at prices above offering price</i>	23
II. Petitioners' procedural arguments are without merit	24
A. <i>The delay in the proceeding constitutes no ground for reversal</i>	24
B. <i>The Commission correctly concluded that petitioners were not entitled to a presumption of good conduct since 1959</i>	28
C. <i>The proceeding was conducted in accordance with the Commission's Rules of Practice</i>	30
<i>Rule 13</i>	30
<i>Rule 16(e)</i>	31
<i>Rule 19(e)</i>	31
D. <i>The Commission did not err in considering violations over a substantial period of time</i>	32
E. <i>Petitioners' other defenses are untenable</i>	34
Conclusion	35

CITATIONS

Cases:

	Page
<i>Adler v. United States</i> , 146 F.Supp. 956 (Ct. of Cl., 1956), <i>certiorari denied</i> , <i>sub nom. Baker v. United States</i> , 352 U.S. 894 (1956).....	26
<i>Amos Treat & Co. v. Securities and Exchange Commission</i> , 306 F.2d 260 (C.A. D.C., 1962).....	27
<i>Behel, Johnsen & Co.</i> , 26 S.E.C. 163 (1947).....	20
<i>Causey v. United States</i> , 240 U.S. 399 (1916).....	26
<i>Chesapeake & Delaware Canal Co. v. United States</i> , 250 U.S. 123 (1919).....	26
<i>Costello v. United States</i> , 365 U.S. 265 (1961).....	27
<i>Deering Milliken, Inc. v. Johnston</i> , 295 F.2d 856 (C.A. 4, 1961).....	27
<i>Guaranty Trust Co. of New York v. United States</i> , 304 U.S. 126 (1938).....	25, 26
<i>Herbert A. Mendell</i> , 31 S.E.C. 491 (1950).....	28
<i>Hersh v. Securities and Exchange Commission</i> , 325 F.2d 147 (C.A. 9, 1963), <i>certiorari denied</i> , 377 U.S. 937 (1964), <i>affirming J. Logan & Co.</i> , (Securities Exchange Act Release No. 6848, July 9, 1962).....	15, 16
<i>Howard F. Hansell, Jr.</i> , 31 S.E.C. 393 (1950).....	28
<i>Kessler v. Federal Communications Commission</i> , 326 F.2d 673 (C.A. D.C., 1963).....	27
<i>Lasdon v. Hallihan</i> , 36 N.E. 2d 227 (1941).....	27
<i>Looper and Company</i> , 38 S.E.C. 294 (1958).....	17
<i>Mason, Moran & Co.</i> , 35 S.E.C. 84 (1953).....	22
<i>McConville v. Florida Towing Corporation</i> , 321 F.2d 162 (C.A. 5, 1963).....	27
<i>Major v. Shaver</i> , 187 F.2d 211 (C.A. D.C., 1951).....	26
<i>National Labor Relations Board v. Andrew Jergens Co.</i> , 175 F.2d 130 (C.A. 9, 1949).....	25
<i>National Labor Relations Board v. Pool Mfg. Co.</i> , 339 U.S. 577 (1950).....	24
<i>Norris & Hirshberg, Inc. v. Securities and Exchange Commission</i> , 177 F.2d 228 (C.A. D.C., 1949).....	2, 16, 34
<i>Northern Pacific Ry. Co. v. Boyd</i> , 228 U.S. 482 (1913).....	26, 27
<i>Pierce v. Securities and Exchange Commission</i> , 239 F.2d 160 (C.A. 9, 1956).....	33

Cases—Continued

Page

<i>R. H. Johnson & Co.</i> , 36 S.E.C. 467 (1955), <i>affirmed sub nom. R. H. Johnson v. Securities and Exchange Commission</i> , 231 F.2d 523 (C.A.D.C., 1956), <i>certiorari denied</i> , 352 U.S. 844 (1956).....	16
<i>Rosenblum v. Rosenblum</i> , 42 N.Y.S.2d 626 (1943).....	27
<i>Russell L. Irish</i> , (Securities Exchange Act Release No. 7718, October 5, 1965).....	29
<i>Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.</i> , 375 U.S. 180 (1963).....	22
<i>Securities and Exchange Commission v. Morgan, Lewis & Bockius</i> , 209 F.2d 44 (C.A. 3, 1953).....	26
<i>Shearson, Hammill & Co.</i> , (Securities Exchange Act Release No. 7743, November 12, 1965).....	21
<i>Sims Motor Transport Lines, Inc. v. United States</i> , 183 F. Supp. 113 (N.D. Ill., 1959), <i>aff'd per curiam</i> 362 U.S. 637 (1960).....	26
<i>Smith v. Illinois Bell Telephone Co.</i> , 270 U.S. 587 (1926)	27
<i>Steen v. Los Angeles</i> , 190 P.2d 937 (1948).....	26
<i>Swift & Co. v. United States</i> , 308 F.2d 849 (C.A. 7, 1962)	27
<i>Thomas Arthur Stewart</i> , 20 S.E.C. 196 (1945).....	19
<i>Thomson & McKinnon</i> , 35 S.E.C. 451 (1953).....	20
<i>United States v. Brass</i> , 37 F. Supp. 698 (E.D. N.Y., 1941)	25
<i>United States v. Monjar</i> , 47 F. Supp. 421 (D.Del., 1942), <i>aff'd</i> 147 F.2d 916 (C.A. 3, 1945), <i>certiorari denied</i> , 325 U.S. 859 (1945).....	34
<i>Utah Power and Light Co. v. United States</i> , 243 U.S. 389 (1917)	25, 26
<i>Wesreb Oil Co.</i> , (Securities Act Release No. 4647, September 30, 1963).....	28

Statutes and Rules:

Securities Act of 1933, 15 U.S.C. 77a, *et seq.*:

Section 17(a), 15 U.S.C. 77q(a).....	2
--------------------------------------	---

Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq.*:

Section 10(b), 15 U.S.C. 78j(b).....	2
Section 15(b), 15 U.S.C. 78o(b).....	1, 2
Section 15(b) (6), 15 U.S.C. 78o(b) (6).....	32

Statutes and Rules—Continued

	Page
Section 15(c) (1), 15 U.S.C. 78o(c) (1)	2
Section 15A, 15 U.S.C. 78o-3.	1, 2
Section 17(a), 15 U.S.C. 78q(a)	34
Section 25(a), 15 U.S.C. 78y(a)	2
Rules under the Securities Exchange Act of 1934, 17 CFR	
240.0-1, <i>et seq.</i> :	
Rule 10b-5, 17 CFR 240.10b-5.	2
Rule 15c1-2, 17 CFR 240.15c1-2.	2
Rule 17a-4, 17 CFR 240.17a-4.	33
Commission's Rules of Practice, 17 CFR 201.1, <i>et seq.</i> :	
Rule 13, 17 CFR 201.13.	30, 31
Rule 16(e), 17 CFR 201.16(e)	30, 31
Rule 19, 17 CFR 201.19.	30, 31
Miscellaneous:	
<i>Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Part Two, Chapter III, page 221 (1940)</i>	18
<i>Securities and Exchange Commission's Report of Special Study of Securities Markets, H.R. Doc. 95, 88th Cong., 1st Sess., Pt. 4 (1963)</i>	2

**In the United States Court of Appeals
for the Ninth Circuit**

No. 20,472

RUSSELL L. IRISH, d/b/a RUSSELL L. IRISH INVESTMENTS,
and RUSSELL LAWSON IRISH, PETITIONERS,

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT.

**BRIEF FOR RESPONDENT SECURITIES AND
EXCHANGE COMMISSION**

JURISDICTIONAL STATEMENT

This is a petition to review an order (R. 1421-30)¹ of the Securities and Exchange Commission entered August 27, 1965, pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b) and 78o-3, revoking the registration as a broker and dealer in securities of Russell L. Irish, d/b/a Russell L. Irish Investments ("Mr. Irish"), expelling him from membership in the National Association of Securities Dealers, Inc. ("NASD"), and naming Russell Lawson Irish, Mr. Irish's son whom he employs as a salesman, as a cause of that revocation and expulsion (R. 1421-1430).² On October 21, 1965, Mr. Irish and Russell

¹ References to pages of the reproduced record are cited as "R. —" and to pages in petitioners' brief as "Br. —".

² Russell Lawson Irish is also a petitioner and joins in the contentions made by his father. No additional argument that he personally did not violate the antifraud provisions or was not a cause of the sanction is offered on his behalf.

Lawson Irish filed a petition to review. Jurisdiction of this Court is based on Section 25(a) of the Securities Exchange Act, 15 U.S.C. 78y(a).

COUNTERSTATEMENT OF THE CASE

Since 1942 Mr. Irish has been registered with the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934. He is a member of the NASD, and has "engaged exclusively in the sale of mutual fund shares for many years" (R. 1422, 1426). The order under review was entered in private proceedings instituted in March 1959 by the Commission pursuant to Section 15(b) and 15A of the Securities Exchange Act.

The Commission found that antifraud provisions of the federal securities laws³ were violated by petitioners in that petitioners churned customers' accounts by "switching" customers from one mutual fund to another;⁴ in that petitioners purchased mutual fund shares for customers in amounts just under minimum "break

³ Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Sections 10(b) and 15(c)(1) of the Securities Exchange Act, 15 U.S.C. 78j(b) and 78o(c)(1), and Rules 10b-5 and 15c1-2 thereunder, 17 CFR 240.10b-5 and 15 c1-2.

⁴ "Switching" is the term usually applied to the churning of customers' accounts where mutual fund shares are involved. For a description of "churning" see *Norris & Hirshberg, Inc. v. Securities and Exchange Commission*, 177 F.2d 228, 232 (C.A.D.C., 1949). See also *Securities and Exchange Commission's Report of Special Study of Securities Markets*, H.R. Doc. 95, 88th Cong., 1st Sess. Pt. 4 at p. 151 (1963).

points”;⁵ and in that Mr. Irish effected sales of mutual fund shares to two customers at prices in excess of the public offering price (R. 1422-1427). Petitioners do not seriously contest the facts as found by the Commission. Their specific contentions as to the facts deal only with the weight given to the evidence (Br. 28-33), although they state that the findings of fact are not supported by the evidence (Br. 28).

Churning.

The Commission analyzed the accounts of Mr. Irish’s nine largest customers over a period of approximately five years⁶ and found that Mr. Irish, “contrary to the customers’ best interest and for his own gain, induced purchases and redemptions of mutual fund shares in the accounts of customers, which were excessive in size and frequency in the light of the character of such accounts” (R. 1422). The Commission’s analysis showed that Mr. Irish “followed a policy of recommending to customers that they redeem the shares of one mutual fund and use the proceeds to buy those of

⁵ “Break points” are points at which quantity discounts as to sales load are made available to purchasers of mutual fund shares. For example, in one of the funds here involved on purchases of shares from \$1 to \$24,999 the purchaser pays an 8½% sales charge, which includes a commission to the dealer of 6%; on purchases from \$25,000 to \$49,999 the sales charge is 5½% and the commission is reduced to 4%. Prospectus of National Securities Series of July 27, 1953, Commission Public File No. 2-10347-1.

⁶ The period analyzed was from September 28, 1953 through October 31, 1958. The proceedings had been instituted March 19, 1959. The Commission noted: “The order for proceedings charged . . . Mr. Irish with violations beginning in 1943, but evidence was introduced only for this shorter period” (R. 1422, n. 2).

another fund, or shift from one series to another series of the same mutual fund, which transactions required the payment of a new sales commission" (R. 1423). Mr. Irish's "policy of switching his customers from one mutual fund security to another", the Commission found, "was highly profitable to himself and detrimental to his customers" and "accounted for \$65,593 of . . . [petitioners'] commissions" from the nine accounts "during the period in question." "In every case", the Commission also found, "the switching of investments resulted in a reduction in the profits which the customer otherwise would have made." (R. 1424.) The Commission further stated that the "sales commission or load paid by these customers on the purchase of mutual fund shares was considerably higher than they would normally pay on the purchase of other securities; the commissions often ran as high as 8¾% of the offering price and included a dealer commission for . . . [Mr. Irish] of as much as 6% of the offering price." (R. 1425.)

Of the nine customers whose accounts were studied, six were farmers or retired farmers, one was a widow, whose sole source of income at the time she testified was her investments, one was a physician and one was an accountant (R. 1422-1423, 477). The Commission found that these customers generally followed Mr. Irish's recommendations. The Commission rejected petitioners' contention that these customers were "sophisticated investors," finding, indeed, that the evidence tended to establish the contrary (R. 1423).

O. George Wagnild, one of the farmer customers, the Commission found, effected 17 purchases of mutual

fund shares, of which 11 occurred in switches. By comparing the value of his account as of October 1958, together with dividend and capital gains distributions since 1953, with what the corresponding total would have been had Mr. Irish not switched him from the funds he held on the earlier date, the Commission found it would have been \$13,805 greater. The Commission found that of the total commissions of \$7,365 from transactions in Mr. Wagnild's account, the sum of \$6,300 was attributable to switches (R. 1423, 1424).

On a similar comparison made of the account of Maurice D. Prince, the accountant customer, the Commission found that he purchased \$214,459 of mutual fund shares in 16 transactions, of which 14 occurred in switches.⁷ The market value of Mr. Prince's interest in mutual fund shares (including dividend and capital gains distributions) was \$32,162 less than it would have been had there been no switches. Of the total commissions of \$7,488 received by petitioners from transactions in Mr. Prince's account during the period studied, the Commission found that the sum of \$7,012 was attributable to switches (R. 1423, 1424).

The Commission found that the other seven of the nine customers whose accounts were studied would also have been substantially better off had there been no switches and that Mr. Irish's commissions from those accounts attributable to switching ranged from \$1,468 to \$11,237 (R. 1424-1425). As to these customers, the

⁷ While the Commission studied all accounts for the period September 1953 through October 1958, this particular account was not sufficiently active from January 1957 to October 1958 to warrant any conclusions with respect to that period (R. 1424, n. 7).

Commission noted in addition that Dr. Milo Harris, the physician customer, effected 21 purchases totalling \$344,111, of which 12 occurred in switches; that Mrs. Therese W. Benedict, the widow, effected during the 27 months that her account was active 6 purchases of \$46,588, of which 4 were in switches; that Harry A. Boger, one of the farmer customers, effected 27 purchases totalling \$395,226, of which 19 occurred in switches; and that the remaining four customers effected, respectively, 16, 20, 33 and 35 purchases, of which 8, 8, 14 and 16 were in switches (R. 1423).

The Commission also found with respect to the nine accounts studied: "Not only was there excessive switching between mutual funds, but switches were in many instances effected after the first fund had been held in the customer's account for a relatively brief period of time" (R. 1423). It found that 37% of mutual fund shares purchased had been held less than a year; 29% between one and two years; about 28% between two and three years; and only 6% had been held for more than three years (R. 1423).

In addition, the analysis of the nine accounts during the five-year period studied showed an "over-all pattern of selling after relatively short periods of retention in the customers' accounts" (R. 1424). The Commission found that "of approximately \$2,692,000 in mutual fund shares purchased from . . . [Mr. Irish] in 195 transactions, about \$959,000 or 36%, acquired in 55 transactions, were resold between one and two years; about \$194,000 or 7%, acquired in 19 transactions, were resold between two and three years; and about \$22,000 or 1%, acquired in 8 transactions, were resold after three years" (R. 1424).

Failure to Disclose Minimum Break Points.

The Commission found that Mr. Irish had defrauded customers in selling them mutual fund shares without adequate disclosure of minimum break points which, if they had been observed, would have reduced his commission charges to them. Thus the Commission found that sales were effected in March 1951 to Evan I. Evans and in October 1952 to Harry N. Boger, both former customers, in amounts of \$23,661 and \$24,000, respectively, when the break point in each case was \$25,000. It appeared that both customers were financially able to make the small additional investments needed to obtain the benefit of break point financing. The Commission found that "had such additional purchases been effected [Mr. Evans and Mr. Boger] would have saved a total of \$1,176 in sales charges, and [Mr. Irish's] commissions would have been reduced by a total of \$609" (R. 1427).

This was the second time Mr. Evans received this type of treatment. Two sales were made to him, one on August 3 and another on August 23, 1950, of a total of \$30,820 of shares of a single mutual fund, with each purchase amounting to less than the \$25,000 break point. If these two purchases had been combined, Mr. Evans' sales load would have been reduced by more than \$900, but Mr. Irish's commissions would have also been reduced—by more than \$600 (R. 1427).

Russell Lawson Irish also followed this practice. On January 4, 1951, he sold shares of a mutual fund to Mr. Prince in the amount of \$16,607, and a week later sold him \$5,272 in the same fund. The Commission found that had Mr. Prince "combined the purchases and invested an additional \$3,121 in the fund to reach the \$25,000 break point, he would have saved

\$750 in sales load and [petitioners'] commissions would have been reduced by \$500" (R. 1427).

On June 7, 1954 Mr. Irish sold \$19,340 of one series of a mutual fund to Harry A. Boger, another of the farmer customers and the father of Harry N. Boger, and two days later sold him \$9,744 of two additional series of that fund. If these sales had been made at the same time Harry A. Boger would have saved \$727 in sales charges and Mr. Irish's commissions would have been decreased by more than \$400. On January 7, 1955 Mr. Irish also sold \$16,538 of shares of another mutual fund to Harry A. Boger and at the same time \$10,779 of shares of the same fund to Harry N. Boger. Under the terms of the prospectus of that fund purchases by members of immediate families could have been combined, which would have made the total amount exceed the break point, thereby causing a saving to the father and son of sales charges of \$400 and causing a reduction of about \$320 in commissions (R. 1427).

Sales at Prices above Offering Price

The Commission also found that Mr. Irish had sold to Louis E. Alboucq, another of his farmer customers, over \$28,000 of two series of a mutual fund and to Evan I. Evans over \$27,000 of the same two series. Under the terms of the mutual fund's prospectus, where the combined purchases of the customers in any series of the fund exceeded \$25,000, the sales commission was to be reduced from 8½ to 6%. Mr. Irish nevertheless charged Mr. Alboucq and Mr. Evans the higher commission, resulting in an overpayment by them of some

\$1,300 and the receipt by Mr. Irish of more than \$800 in commissions to which he was not entitled (R. 1426).⁸

The Delay in the Proceeding.

Based on the foregoing, both the Commission (R. 1426, 1427) and the hearing examiner (R. 1392) concluded that Mr. Irish willfully violated the antifraud provisions of the securities laws (see p. 2, *infra*). The Commission, however, disagreed with the hearing examiner, who, notwithstanding the above findings of serious violations of the antifraud provisions, concluded that it was not in the public interest to revoke Mr. Irish's registration "because of the length of time that elapsed since the hearings were closed in September 1959, and the 'presumption,' which he considered to exist in the absence of information in the record to the contrary, that . . . [Mr. Irish's] conduct had been good during the interval" (R. 1428). The Commission held that Mr. Irish was not entitled to this presumption since the record was silent as to any such conduct, since the very nature of the violations found precluded such a presumption, and since similar and additional violations by Mr. Irish had been found in an earlier proceeding (R. 1429). The proceeding to which the Commission referred had been instituted before the NASD in January 1955.⁹ The Commission noted that even after the affirmance of the NASD's decision by

⁸ While Mr. Irish advised these two customers and the Commission that he would refund the excess commissions, the payment is not to be made until the completion of these proceedings (R. 1426, n. 13).

⁹ The proceeding involved the accounts of 12 customers for the period 1943 to 1954, apparently including seven of the customers

that self-regulatory body's Board of Governors in October 1955, Mr. Irish continued his switching activities (R. 1429).

The Commission, in considering the question of delays in the proceeding, found that in view of the fact that the proceeding had been private, petitioners were not prejudiced by the lapse of time. It also found that petitioners had contributed to the delay and "had failed to take any steps to expedite" the proceeding. "[I]n light of the seriousness of the violations found", the Commission concluded that dismissal was not warranted and that "the public interest require[d] the imposition of a sanction" (R. 1429). This was the second time the Commission considered the question of delay in these proceedings. On December 12, 1963, the Commission had denied petitioners' motion for a permanent stay or a dismissal of the proceeding, noting, *inter alia*, that "no proof of financial hardship resulting from the delay [had] been offered by [petitioners]" (R. 1162). Petitioners sought review in this Court of that order and this Court dismissed the petition to review.¹⁰

In the decision under review the Commission "care-

involved in the instant proceeding (Dr. Harris, Mr. Prince, Mrs. Benedict, and four of the farmer-customers). Mr. Irish was suspended from the NASD for 15 days and fined \$3,000. He did not seek review by the Commission of the NASD's decision (R. 1429).

Petitioners were also the subjects of a later NASD disciplinary proceeding (see pages 28-30, *infra*), but this was not a basis for the Commission's determination that there was no presumption of good conduct.

¹⁰ *Irish v. Securities and Exchange Commission* (No. 19,095, March 30, 1964).

fully reviewed" the hearing examiner's recommendation and its own previous ruling (R. 1429).¹¹ At the close of the evidentiary hearing, held in Spokane, Washington, from September 21 through September 24, 1959, it had been stipulated that there would be included in the record depositions and interrogatories of certain witnesses who were then unavailable and whose testimony was desired by one or both of the parties (R. 283, 319). The last of these depositions was not filed until April 1961 (R. 1428). Prior to the completion of the taking of the depositions, counsel for petitioners on March 1, 1961 had suggested to the Commission's Seattle Regional Office "that possibly some stipulation be worked out to windup the instant case" (R. 1138). While there were conversations from time to time between petitioners' counsel and counsel for the Commission attached to the Commission's Seattle Regional Office, it was not until August 1962, when the Chief Enforcement Attorney of the Commission's Trading and Markets Division in Washington, D. C. went to Seattle to meet with Mr. Irish and his counsel that a definitive proposed settlement was discussed (R. 1136-1142). After several meetings and subsequent correspondence settlement efforts failed (R. 1148-1151).

Subsequent delay appears to have resulted in part from the preparation of supplementary analyses of the accounts of petitioners' customers. At the hearings,

¹¹ The Commission included two members, Commissioners Budge and Wheat, who had been appointed since the previous ruling.

petitioners had objected to the introduction into evidence of the Commission's analyses of the customers' accounts on the ground that they were incomplete because they did not go beyond December 31, 1956. The hearing examiner at that time ruled that petitioners could prepare supplementary exhibits to bring the analyses through October 31, 1958, or the Division could submit such supplementary analyses (R. 221). After settlement negotiations had broken down, the Division commenced the preparation of the supplementary analyses. When these were submitted to petitioners' counsel he failed to comment thereon until called by a representative of the Division to determine petitioners' position (R. 1115-1116, 1160, 1428). Counsel stated that he intended to make objections to the introduction of the supplementary analyses, and in a letter dated July 30, 1963, confirming the telephone conversation, he stated that depositions and interrogatories "would still have to be admitted in evidence and, at that point, that proposed findings and conclusions could be made on behalf of the Commission and on behalf of the Irishes" (R. 1156). On August 8, 1963, the Division forwarded to counsel for petitioners a formal application for the introduction of the analyses into evidence and again, since counsel for petitioners did not respond for over a month, he was called by a representative of the Division (R. 1160, 1115, 1428). During this conversation counsel for petitioners stated that he would not stipulate to the introduction of the documents (R. 1116). By letter dated September 13, 1963, counsel for petitioners confirmed this telephone conversation and stated that petitioners intended to move to dismiss

the proceeding "in the next several days" (R. 1117).

The Division moved (1) to reconvene the hearing for the limited purpose of introducing the analyses into the record and (2) to have the hearing examiner prescribe a time schedule for the filing of proposed findings and briefs. The Division's motion was denied by the hearing examiner on October 23, 1963, on the ground of laches and lack of due process. The Division appealed to the Commission, and petitioners, on October 29, 1963 (R. 1087), for the first time moved to dismiss the proceeding (R. 1161, 1428).¹² By order dated December 12, 1963, the Commission overruled its hearing examiner, denied petitioners' motion to dismiss the charges, determined that the proceeding be deemed closed, and directed that, as preparatory steps to the filing of a recommended decision by the hearing examiner, the parties should file proposed findings and supporting briefs (R. 1162). The Commission found that following the evidentiary hearing, in April 1961, neither the staff nor the petitioners had ever requested the hearing examiner to schedule the filing of proposed findings and briefs.

The Division's proposed findings and brief were filed on January 13, 1964 (R. 1163). Petitioners sought review in this Court on January 18, 1964. On February 10, 1964 this Court denied petitioners' motion to stay the administrative proceedings pending review. On

¹² The Division did not in its application for review of the hearing examiner's refusal to schedule proposed findings of fact and conclusions of law insist that the hearing be reconvened for the introduction of the supplementary analyses which were merely recapitulations of evidence already in the record and were being offered as a convenience to petitioners (R. 1102).

March 2, 1964, petitioners filed their proposed findings and brief (R. 1319) and the Division filed its reply brief on March 12, 1964 (R. 1363). This Court on March 30, 1964 dismissed the petition to review. The hearing examiner entered his recommended decision on April 3, 1964 (R. 1375). Exceptions were taken by the Division on April 13, 1964 (R. 1396) and a brief was filed in support thereof on April 23, 1964 (R. 1405). Petitioners sought and were granted an extension of time until June 2, 1964 to file a brief in support of exceptions to the hearing examiner's recommended decision (R. 1414, 1417). Having received no brief by June 10, 1964, the Commission took the proceeding under advisement. On August 27, 1965, the Commission entered the opinion and order from which petitioners now seek review.¹³

SUMMARY OF ARGUMENT

The Commission correctly found that petitioners, who enjoyed the trust and confidence of their customers, violated their fiduciary obligations to them and the antifraud provisions of the securities laws: (1) by churning their customers' mutual fund accounts; (2) by repeatedly effecting purchases of mutual fund shares for customers just below minimum break points and failing adequately to disclose to customers that they could save money by slightly larger investments so as to take advantage of lower sales charges; and (3) by effecting sales to customers of mutual fund shares at prices above the offering price.¹⁴ These activities, while

¹³ On September 17, 1965, the Commission stayed the effectiveness of its order pending the determination of this petition to review (R. 1436).

¹⁴ The last category does not apply to Russell Lawson Irish.

detrimental to the interests of petitioners' customers, resulted in substantially increased commissions for petitioners.

Petitioners seek reversal of the Commission's order on the ground of delay during the proceeding. Petitioners, however, did not attempt to expedite the proceeding and, indeed, have contributed to the delay. Moreover, they have not shown that they have suffered any injury by reason of the delay. Accordingly, petitioners have not shown the requisite elements of laches. In any event, the doctrine of laches is not applicable against the government.

Petitioners' other procedural contentions are also without merit.

ARGUMENT

I. The Commission Properly Found That Petitioners Had Violated the Antifraud Provisions of the Securities Laws and Its Decision Is Supported by Substantial Evidence.

A. Excessive Trading in Customers' Accounts.

Petitioners cannot and do not contend that churning of customers' accounts does not violate the antifraud provisions of the securities laws. This Court has affirmed *per curiam*, "upon grounds and for the reasons stated" by the Commission, a holding of the Commission that churning of customers' accounts violates the antifraud provisions of the securities laws. *Hersh v. Securities and Exchange Commission*, 325 F.2d 147 (1963), *certiorari denied*, 377 U.S. 937 (1964), *affirming J. Logan & Co.*, (Securities Exchange Act Release No. 6848, July 9, 1962). In that case the Commission had pointed to its frequent emphasis that "inherent

in the relationship of every broker-dealer with his customer is the implied vital representation that the customer will be dealt with fairly and honestly." *J. Logan & Co., supra* at p. 10. Similarly, the United States Court of Appeals for the District of Columbia Circuit has specifically held that excessive trading in a customer's account violates the antifraud provisions of the Securities Exchange Act. *Norris & Hirshberg, Inc. v. Securities and Exchange Commission*, 177 F. 2d 228, 231-232 (1949). A typical instance of churning was described by the Commission in *R. H. Johnson & Co.*, 36 S.E.C. 467, 485 (1955), *affirmed sub nom. R. H. Johnson & Co. v. Securities and Exchange Commission*, 231 F. 2d 523 (C.A. D.C., 1956), *certiorari denied*, 352 U.S. 844 (1956):

"The customers involved were uninformed or inexperienced in securities matters and generally relied upon the salesman's advice with respect to their securities transactions. Under these circumstances, Sharpe, Woods, Lewis and Quinn occupied a position of trust and confidence with respect to these customers and were under a duty to act in their best interests in effecting transactions in their accounts. Instead, they used that relationship to cause an excessive number of transactions, which frequently involved multiple trading in the same security and switches from one security to another, It is evident that the salesmen were motivated by the desire to produce income for themselves as well as registrant by inducing an undue number of transactions on which

commissions and profits could be taken without regard to the interest of the customers and in violation of the fiduciary duty which they owed to them.”

See also *Looper and Company*, 38 S.E.C. 294, 300-301 (1958).

Although petitioners appear to argue that their activities do not constitute churning (Br. 28-29), it is clear that the requisite elements of churning under the foregoing authorities have been established: (1) a relationship of trust and confidence between the broker-dealer and his customers giving rise to a duty on his part to act in their best interest; and (2) violation of his fiduciary obligations by the broker-dealer by causing an excessive number of transactions in his customers' accounts resulting in increased commissions.

There can be no doubt that a relationship of trust and confidence existed between Mr. Irish and his customers. The nine customers whose accounts were analyzed herein were not sophisticated investors. They looked to Mr. Irish for guidance in investing in mutual fund shares. They constantly followed his changing recommendations relating to the purchase and sale of mutual fund shares (R. 1423). Indeed, Mr. Irish admitted that he played a very active role as investment adviser (R. 371).

Nor can there be any doubt that Mr. Irish took advantage of the relationship of trust and confidence which obtained with his customers to cause an excessive number of transactions in their accounts to their detri-

ment and to his own advantage.¹⁵ The hearing examiner and the Commission could and did properly assume that the great number of switches in the customers' accounts (see pages 4-6, *supra*) were motivated by petitioners' desire to increase their commissions.

Two factors peculiar to mutual funds make excessive trading therein even more damaging to customers than excessive trading in other securities. First, the high sales commissions skim off around 9% of the money invested at the time the purchase is effected. Second, the funds themselves, generally speaking, are broadly diversified and their management and investment advisory firms constantly supervise the fund portfolio

¹⁵ "Switching" an investor from one mutual fund (open-end investment company) to another as a means of obtaining increased commissions is an abuse which is facilitated by the redemption feature of mutual funds. This was spelled out in the Commission's report on investment companies which led to the passage of the Investment Company Act of 1940, 15 U.S.C. 80-1a, *et seq.*, as follows:

"The nature of open-end companies and fixed-trusts, particularly their obligation to redeem their shares or certificates at asset value, has made their securities vulnerable to 'switching' operations, i.e., attempts by dealers to persuade customers to sell the shares of one investment company and to use the proceeds to buy those of another. Distributors, dealers, and salesmen, profited from each sale of an investment company issue, whether the sale involved the investment of additional funds by a customer or merely his liquidation of one issue to buy another. Such operations may, however, be costly to investors since they involve the payment of a new load on each shift.

"The prevalence of switching of open-end company shares or fixed-trust certificates is attributable to the ability of the dealer readily to liquidate the shares or certificates taken in payment for those of the new company or trust because of the rights of redemption." *Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Part Two, Chapter III, page 221 (1940).*

to determine what investments are most appropriate. Even Mr. Irish acknowledged the importance of management in mutual funds (R. 368-369). The Commission in *Thomas Arthur Stewart*, 20 S.E.C. 196, 201-202 (1945), noted that the above two factors made the switching of mutual funds inherently unprofitable except under very unusual circumstances, and, of course, except from the broker-dealer's own personal point of view, stating:

"In view of the selling load included in the purchase price, in-and-out trading in the subject shares could be profitable only (a) if the purchase were followed by a market appreciation of the portfolio or an increase in the fund's net current assets *sufficient to exceed the selling load of 8 percent to 9½ percent*, or (b) if a redemption were followed by an equivalent recession and subsequent repurchase. *In switches from one trust to another in simultaneous purchases and redemptions, the very diversification of the trust portfolios decreased the likelihood that any market-wise benefit would be gained by the customers, since they were continuously in the market, yet repeatedly paying substantial selling loads.* Increased activity in the customers' accounts increased Stewart's commissions but decreased the customers' chances for profit." (Second emphasis added.)

Not surprisingly, the record establishes in the instant case that results for each of the nine customers whose

accounts were analyzed would have been substantially better if the switching had not occurred (pages 4-6, *supra*). From the standpoint of petitioners' commissions, however, the record showed that during the five-year period under analysis commissions paid by the nine customers and attributable to churning amounted to \$66,593, or over 50% of all commissions collected from these nine accounts (R. 1424).

Petitioners contend (Br. 28-29) that their churning activities did not violate the antifraud provisions because no secret profits or discretionary accounts were involved. In support thereof they cite (Br. 29) *Behel, Johnsen & Co.*, 26 S.E.C. 163 (1947). While secret profits were involved in that case, the Commission expressly noted " 'Churning' may occur where a firm confirms as agent and discloses its commissions." 26 S.E.C. at 168. Petitioners (Br. 29) also cite *Thomson & McKinnon*, 35 S.E.C. 451 (1953), in which the Commission recognized that where a customer initiates his own trading, the broker has not violated the antifraud provisions. The facts of the instant case show that petitioners' customers heeded and followed petitioners' advice and that the switching of the funds' shares in the customers' accounts originated with petitioners and not with the customers (R. 49, 57, 59, 152, 198, 485).

Petitioners also contend that no churning violations occurred because customers were furnished with confirmations "which stated that the costs of any exchange of securities should always be weighed by the customer" (Br. 29). The illegal transactions took place over the period 1953 through 1958 and the confirmations to

which petitioners refer were not employed until November 11, 1955.¹⁶ In any event, such an after-the-fact statement in a confirmation is not the type of disclosure which would have to be made to enable the customer to make an informed judgment; it would tend to be disregarded in the face of petitioners' affirmative recommendations to sell and purchase. Petitioners cannot defraud their customers and then rely for exculpation upon their customers' failure to object. As the Commission stated in *Shearson, Hammill & Co.*, (Securities Exchange Act Release No. 7743, November 12, 1965) at p. 31:

"the responsibility for refraining from excessive trading, which even if each transaction shows a profit, will deplete the account or reduce the overall profit that might otherwise be made because of the commission paid on each transaction, cannot properly be avoided by pointing to the failure of an unsophisticated customer to object."

B. Sales Below Break Points.

With respect to petitioners' failure adequately to disclose to customers that they could save money by slightly larger investments so as to take advantage of lower sales charges, there also can be no doubt that petitioners violated their fiduciary obligations and the antifraud provisions. The Commission has pointed out in a case involving a broker-dealer who sold mutual fund shares to an order of nuns in amounts slightly

¹⁶ Mr. Irish stated that he began using the rubber stamp "warning" legend on about that date, and that he did so because of his NASD difficulties (R. 314-316).

below break points, that a broker-dealer's fiduciary duty is to make adequate advance disclosure of the break points, and this duty is not satisfied by merely furnishing the customer with a prospectus describing them. *Mason, Moran & Co.*, 35 S.E.C. 84, 90 (1953).¹⁷ Further, as Mr. Irish has stated, he, in effect, acted as an investment adviser for his customers (R. 371). The Supreme Court has noted, in describing the fiduciary obligations of an investment adviser: "Courts have imposed on a fiduciary an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194, (1963).

Petitioners contest (Br. 29-30) the Commission's findings (R. 1427) that they did not adequately disclose minimum break points to their customers. They state (Br. 29) that customers testified "they were always advised of break points and even their attention was called to the statements on confirmations (Tr. 1-469; 874-916; 917-918)."

The Commission found, however, in none of the situations where there were break point violations did it appear that adequate disclosure had been made prior to the transaction (R. 1427). Harry N. Boger testified that he did not even learn the meaning of the term

¹⁷ As the Commission there suggested, since the portfolios were already diversified, it is unlikely that the customers were caused to invest in two funds for purposes of greater diversification of their investments, rather than to obtain increased commissions for the broker-dealer. *Ibid.*

“break point” until 1954 (R. 254), over a year after the first break point violation to which he was subjected (see page 7, *supra*). Russell Lawson Irish was asked whether he ever discussed with Mr. Prince “the desirability of combining the purchases into a single fund in order to have a break point advantage” and replied “No, not at that time as far as my memory recalls” (R. 164). Russell Lawson Irish further testified that he had not discussed this possibility with Mr. Prince even when he had recommended on two consecutive days in May 1954 that Mr. Prince purchase \$12,000 in one fund and \$17,000 in another (R. 165). As to the statement on the confirmations, this related to switching, not break points, and was, as noted above, not employed until after November 11, 1955, after all the break point violations charges had occurred (R. 314-316).

C. Sales at Prices Above Offering Price.

The facts involved in these two violations occurring in 1954 are described at page 8 of this brief. Petitioners' brief asserts that these failures to obtain reduced sales charges and consequent increased commissions were “the result of an error caused by the mutual fund in its offices in New York City” (Br. 30). Again the record is to the contrary. An employee of Distributor's Group, Inc., which is the sponsor and manager of Group Securities, Inc., the fund to which petitioners refer, testified that when the orders were received he called petitioners and was expressly told that the orders were not single orders and were not to be combined to achieve lower break point advantages (R. 539-541).

Mr. Irish also attempted to explain his failure to combine the funds on the ground that he did not know that two series of the same fund could be combined. But the prospectus for that fund stated that they could (R. 53-56, 343-345). And the record shows that shares of the Group Securities Series were among those most frequently sold by Mr. Irish (R. 918-934).

II. Petitioners' Procedural Arguments Are Without Merit

A. The Delay in the Proceeding Constitutes no Ground for Reversal.

Petitioners seek reversal of the Commission's order on the ground that the lapse of time in the proceeding has been inexcusable and has resulted in prejudice to them (Br. 17-18). As we have shown (pp. 10-14, *supra*), however, petitioners have contributed to the lapse of time in the proceeding, have never attempted to expedite the proceeding and have not shown that they have suffered any injury.

Petitioners did not move to dismiss until the Commission's staff sought to schedule the filing of proposed findings and conclusions. Indeed, when the Commission's staff sought to conclude the proceeding, counsel for petitioners claimed that this action was taken "suddenly, arbitrarily and capriciously" (R. 1345).

Under these circumstances, neither due process nor any provision of the Administrative Procedure Act authorizes dismissal of the proceeding on the ground of delay. Compare *National Labor Relations Board v.*

Pool Mfg. Co., 339 U.S. 577, 581 (1950), where the Supreme Court, considering the question of a two and one-half year delay of the NLRB to enforce one of its orders, cited this Court's opinion in *National Labor Relations Board v. Andrew Jergens Co.*, 175 F. 2d 130, 134 (1949), and stated: "The employer, who could have obtained review of the Board's order when it was entered, § 10(f), is hardly in a position to object."

The very cases cited by petitioners on page 22 of their brief hold that the doctrine of laches is not applicable to the government. Mr. Justice Stone in *Guaranty Trust Co. of New York v. United States*, 304 U.S. 126, 132 (1938), stated the rationale of the rule of non-application as follows:

"Regardless of the form of government and independently of the royal prerogative once thought sufficient to justify it, the rule is supportable now because its benefit and advantage extend to every citizen, including the defendant whose pleas of laches or limitation it precludes; and its uniform survival in the United States has generally been accounted for and justified on grounds of policy rather than upon any inherited notions of the personal privilege of the king."

The doctrine of laches has been held to be inapplicable in numerous cases in which the government, as here, has instituted an action in its sovereign capacity to protect the public interest. See, *e.g.*, *Utah Power and Light Co. v. United States* 243 U.S. 389, 409 (1917) (action to enjoin private use of public lands); *United States v. Brass*, 37 F. Supp. 698, 699 (E.D. N.Y., 1941)

(action to vacate certificate of naturalization); *Sims Motor Transport Lines, Inc. v. United States*, 183 F. Supp. 113 (N.D. Ill., 1959), *aff'd per curiam* 362 U.S. 637 (1960) (action to set aside ICC cease and desist order). It has, further, been explicitly held that the doctrine of estoppel, which includes laches, cannot be invoked against an administrative agency. *Securities and Exchange Commission v. Morgan, Lewis & Bockius*, 209 F.2d 44, 49 (C.A. 3, 1953).¹⁸

Even assuming arguendo that the doctrine of laches were applicable, it would be necessary for petitioners to show "inexcusable delay" and "non-action . . . operat[ing] to damage the defendant or to induce it to change its position," *Northern Pacific Ry Co. v. Boyd*, 228 U.S. 482, 509 (1913). Contrary to petitioners' contention (Br. 18), "there is no neces-

¹⁸ Petitioners assert (Br. 21) that "cases carefully distinguish circumstances under which the government has not received any rights or where its actions are void and the rule is carefully so limited," citing *Guaranty Trust v. United States*, 304 U.S. 126, *supra*, at 135, 141; *Utah Power & Light Co. v. United States*, 243 U.S. 389, *supra* at 409; *Causey v. United States*, 240 U.S. 399, 402 (1916); and *Chesapeake & Delaware Canal Co. v. United States*, 250 U.S. 123, 126 (1919). A reading of these cases shows no distinction. In *Steen v. Los Angeles*, 190 P.2d 937 (1948), a suit against the City of Los Angeles, the court did not dismiss the action. *Major v. Shaver*, 187 F.2d 211 (C.A. D.C., 1951), is not a case in which the government was a party.

Petitioners also contend (Br. 26) that "federal courts have viewed the lack of due process because of administrative irregularities and delay . . . with sufficient gravity that the courts have held there is no absolute requirement that a party exhaust his administrative remedies . . .", citing *Adler v. United States*, 146 F. Supp. 956 (Ct. of Cl., 1956), *certiorari denied, sub nom. Baker v. United States*, 352 U.S. 894 (1956). That case involved no question of delay and held that discharged federal employees must exhaust their administrative remedies before seeking the aid of a federal court.

sary estoppel arising from the mere lapse of time.” *Ibid.* See also *Costello v. United States*, 365 U.S. 265, 282 (1961); *McConville v. Florida Towing Corporation*, 321 F. 2d 162, 168 (C.A. 5, 1963).¹⁹

¹⁹ The cases cited by petitioners (Br. 18) in support of the statement that mere lapse of time voids the proceeding and constitutes a violation of due process of law are not in point. In *Smith v. Illinois Bell Telephone Co.*, 270 U.S. 587, 591 (1926), the utility showed specific injury flowing from the inaction of the regulatory body in that it was forced to keep its old and inadequate rates in effect.

Deering Milliken, Inc. v. Johnston, 295 F. 2d 856 (C.A. 4, 1961), involves the question whether a federal agency (the National Labor Relations Board) may be enjoined on the basis of Section 10(e) of the Administrative Procedure Act from conducting lengthy hearings covering ground covered in a prior hearing. *Swift & Co. v. United States*, 308 F. 2d 849 (C.A. 7, 1962), does not involve any question of delay in administrative proceedings but only the question of whether due process is violated by a hearing examiner's admission of certain evidence into an administrative proceeding. *Amos Treat & Co. v. Securities and Exchange Commission*, 306 F. 2d 260 (C.A. D.C., 1962), involves the question whether this Commission may be enjoined from continuing a proceeding instituted at a time when one of the Commissioners had been director of one of the operating divisions.

Kessler v. Federal Communications Commission, 326 F. 2d 673 (C.A. D.C., 1963), again involve no question of administrative delay but whether a “freeze” order of the FCC was valid.

Lasdon v. Hallihan, 36 N.E. 2d 227 (1941), among the cases cited by petitioners as establishing that the right to conduct a business is a property right (Br. 18), also shows that a government agency may regulate business practices. *Rosenblum v. Rosenblum*, 42 N.Y. S. 2d 626 (1943), to the effect that everyone is entitled to his day in Court, does not support petitioners' statement (Br. 18) that they have not “been accorded orderly process” and “granted only inordinate delays.” That case involved the question whether during the second World War a husband in a divorce action in New York could serve his wife by publication while she was residing in occupied France.

B. The Commission Correctly Concluded that Petitioners Were Not Entitled to a Presumption of Good Conduct since 1959.

In disagreeing with the hearing examiner as to the weight given by him to the delay in the proceeding, the Commission found that petitioners were not entitled to a presumption of good conduct since 1959 when the hearings were closed in view of the absence of evidence in the record on this point (R. 1428-1429).²⁰ Petitioners contend (Br. 19) that under "any rationale of due process" they were entitled to this presumption. The Commission found that no such presumption was warranted in light of the violations found and in view of the fact (see pages 9-10, *supra*) that Mr. Irish had continued his switching activities (in the accounts, among others, of some of the nine customers involved in the instant proceeding) after the NASD in 1955 had suspended him from membership for 15 days and fined him \$3,000 for such activities.

Petitioners contend (Br. 19-20) that the Commission "callously and with cynical disregard" of petitioners' rights "ignored that presently pending before it" at the time it entered the order under review was an appeal by petitioners from another decision of the NASD relating to their activities for the years 1956-1962. Petitioners suggest that the Commission has acted

²⁰ *Wesreb Oil Co.*, (Securities Act Release No. 4647, September 30, 1963); *Howard F. Hansell, Jr.*, 31 S.E.C. 393 (1950); *Herbert A. Mendell*, 31 S.E.C. 491 (1950), cited by petitioners (Br. 19), are not in point. In those cases, the record affirmatively showed that the respondents therein had conducted themselves in a proper manner subsequent to the entry of injunctions against them.

in an inconsistent manner because “*identical* commissioners” found that revocation of Mr. Irish’s registration in the instant case was required by the public interest and found that in the NASD appeal the public interest required that the penalties assessed by the NASD should be reduced to censure and nominal costs (Br. 20).²¹

This is not what occurred. The NASD’s District Committee found that petitioners had violated the extension of credit provisions of Regulation T under the Securities Exchange Act. At the same time the District Committee dismissed a complaint that petitioners had churned the accounts of their customers. Upon review the NASD’s Board of Governors affirmed the District Committee’s determination that petitioners had violated Regulation T and reversed the District Committee and reinstated the charge that accounts had been churned. Upon review, the Commission disagreed with several of the findings of the Board of Governors and of the District Committee with respect to the violations of Regulation T and reduced the penalty. *The Commission further found that the Board of Governors had erred in reinstating (more than 30 days after dismissal by the NASD’s District Committee) the charge of churning because, under the NASD’s rules such reinstatement could only have been made within 30 days after such dismissal.* Accordingly, the Commission held that the Board could not consider this charge.

²¹ *Russell L. Irish*, (Securities Exchange Act Release No. 7718, October 5, 1965). The Commission also held that sanctions and costs against Russell Lawson Irish should be cancelled.

There is thus no inconsistency between the Commission's decision under review here based on petitioners' churning activities and its holding on review of the NASD's decision that the charge of churning made there was not properly before its Board.

C. The Proceeding Was Conducted in Accordance with the Commission's Rules of Practice.

Petitioners further attack the Commission's decision on the ground that the proceedings were conducted in violation of the Commission's Rules of Practice. Specifically, petitioners contend that Rules 13, 16(e) and 19 of the Commission's Rules of Practice, 17 CFR 201.13, 16(e) and 19, were violated (Br. 23, 25, 27-28). The rules cited by petitioners are either not applicable to this proceeding or, if applicable, were not violated.

Rule 13.

Rule 13(c) of the Commission's Rules of Practice provides in part that a "convened hearing may be adjourned to such time and place as may be ordered by the Commission or by the hearing officer. It is the policy of the Commission that such adjournments shall be for not more than 30 days and in no event shall a hearing officer order an adjournment for a period in excess of 45 days." The applicability of Rule 13 to these proceedings was considered by the Commission at the time it denied petitioner's motion to dismiss the proceeding (see page 10, *supra*). The Commission held that Rule 13 did not apply because it "was not adopted by the Commission until after the hearing was

closed in 1959 subject to the filing of depositions, and no adjournment was ordered by the hearing examiner following the filing of the last deposition in April 1961, when such limitation was in effect" (R. 1162).²²

Rule 16(e).

Petitioners' reliance on Rule 16(e) of the Rules of Practice is also misplaced. Rule 16(e) directs, "At the end of every hearing, the hearing officer shall, after consultation with the parties, provide the period within which . . . proposed findings and conclusions and supporting briefs are to be filed . . ., provided, however, that the period within which the first filing is to be made normally should be no more than 30 days, and shall not exceed 60 days, after the close of the hearing." Like Rule 13, Rule 16(e) did not become effective until October 1, 1960, after the hearings had been closed.²³ When Rule 16(e) was in effect, at the time the depositions were made a part of the record, petitioners did not request the hearing examiner to schedule the filing of proposed findings and conclusions.

Rule 19(e).

Petitioners also rely upon Rule 19(e) (Br. 27-28), but this rule is applicable only in the case of orders temporarily suspending a broker-dealer registration pending decision on whether permanent revocation should be ordered. No such temporary suspension

²² Rule 13 was adopted as part of a general revision of the Commission's Rules of Practice and did not become effective until October 1, 1960, 25 Fed. Reg. 6719, 6732 (1960).

²³ 25 Fed. Reg. 6719, 6733 (1960).

proceeding was involved here. See Section 15(b)(6) of the Securities Exchange Act, 15 U.S.C. 78o(b)(6).

D. The Commission Did Not Err in Considering Violations Over a Substantial Period of Time.

Petitioners argue that the Commission's decision was based upon "improperly admitted records" and evidence "that included testimony and exhibits pertaining in time as much as 18 years prior in time to the date of the 1959 hearings, well beyond the maximum three and six years required by the Respondent's own rules for holding books and records by . . . [petitioners]" (Br. 28, 31). Petitioners thus suggest that the Commission decided this case on evidence going back as far as 1941 and they argue that the Commission may not properly inquire into violations occurring more than six years prior to the date of a hearing (Br. 25-26, 31).

The Commission's opinion makes clear that the earliest violation it considered was in 1950 not 1941. In connection with petitioners' switching activities, it considered only evidence for the years 1953-1958 (R. 1422). With respect to the Commission's finding that Mr. Irish had sold mutual fund above the offering price, two transactions in 1954 were considered (R. 1426). Only in the case of petitioners' failure to advise customers of minimum break points did the Commission go back beyond 1953. While it found break point violations in the years 1954 and 1955, it also found them in 1950, 1951 and 1952 (R. 1427). Accordingly, the argument that the Commission can go back only six years, even if valid, would only apply to certain break point

violations and to none of the other violations found by the Commission.

In any event, petitioners' argument erroneously presupposes that the period of inquiry into violations of the securities laws by a broker-dealer in an administrative proceeding is governed by a bookkeeping rule. Rule 17a-4, 17 CFR 240.17a-4, which requires that a broker and dealer shall keep certain records for a period of "not less than 6 years." This rule does not purport to be and has never been interpreted as a limitation on actions by the Commission. As counsel for petitioners correctly conceded during the course of the hearings, "there is no true civil statute of limitations as to the Commission's right to act against . . . broker dealers" (Br. 13.) Petitioners' argument concerning a limitation on actions appears to be based on the misconception that these proceedings are penal. This Court rejected a similar argument in *Pierce v. Securities and Exchange Commission*, 239 F. 2d 160, 163 (1956), stating:

"In our view, petitioner misinterprets the purpose of the broker-dealer registration law here involved. Denial of registration is not to be regarded as a penalty imposed on the broker. To the contrary, it is but a means to protect the public interest."

E. *Petitioners' Other Defenses Are Untenable.*

Petitioners also argue (Br. 32) that they were prejudiced by the staff's request on May 27, 1959, to inspect their books and records on the ground that such request was for an "unbridled investigation or 'fishing expedition' into an adversary's books and records" While the staff request was well within the scope of Section 17(a) of the Securities Exchange Act, 15 U.S.C. 78q(a), it is not necessary for this question to be considered since petitioners did not comply with the staff's request. Since no findings of violation were proposed or based thereon, petitioners could not have been prejudiced.

Petitioners further suggest (Br. 28-29) that they did not violate the antifraud provisions because "[n]o customers ever launched a complaint nor had the . . . [petitioners] lost any of their customers." The fact that petitioners' customers may not have appreciated that they were being defrauded is no reason why petitioners should be continued in business. The securities laws are designed, *inter alia*, to protect "those who lack business acumen,"²⁴ or persons who have been described as "the investing and usually naive public."²⁵

²⁴ *United States v. Monjar*, 47 F.Supp. 421, 425 (D.Del., 1942) *aff'd* 147 F.2d 916 (C.A. 3, 1945), *certiorari denied*, 325 U.S. 859 (1945).

²⁵ *Norris & Hirshberg, Inc. v. Securities and Exchange Commission*, 177 F.2d 228, 233 (C.A. D.C., 1949).

CONCLUSION

For the foregoing reasons the petition for review should be denied.

Respectfully submitted,

DAVID FERBER,

Solicitor.

EDWARD B. WAGNER,

Special Counsel.

MARTIN D. NEWMAN,

Attorney.

*Securities and Exchange Commission,
Washington, D. C. 20549.*

Dated: July, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ DAVID FERBER,

Solicitor,

Securities and Exchange Commission.



No. 20472

IN THE
United States
Court of Appeals

For the Ninth Circuit

RUSSELL L. IRISH, dba
RUSSELL L. IRISH INVESTMENTS
Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION
Respondent.

PETITION FOR REHEARING

GRANT L. KIMER
RINER E. DEGLOW
Attorneys for Petitioner

925 Paulsen Building
Spokane, Washington
99201

NATIONAL PRINTING CO.

FILED

NOV 15 1986

CLERK

No. 20472

IN THE
United States
Court of Appeals

For the Ninth Circuit

RUSSELL L. IRISH, dba
RUSSELL L. IRISH INVESTMENTS
Petitioner,

VS.

SECURITIES AND EXCHANGE COMMISSION
Respondent.

PETITION FOR REHEARING

GRANT L. KIMER
RINER E. DEGLOW
Attorneys for Petitioner

925 Paulsen Building
Spokane, Washington
99201



INDEX

	<i>Page</i>
Index	i
Table of Cases	ii
Petition for Rehearing	1

FIRST:

The Hearing Examiners recommended decision should be reinstated as after a four-year delay, from trial to decision, he was unable to make any finding on credibility of any of the witnesses, to support any finding that Irish's registration should be revoked.

TABLE OF CASES

	<i>Page</i>
<i>Adamson v. Gilliland</i> , 242 U.S. 350, 353, 37 S.Ct. 169, 61 L.Ed. 356	4
<i>Alabama Power Co. v. Ickes</i> , 302 U.S. 464, 477, 58 S.Ct. 300, 82 L.Ed. 374	4
<i>Davis v. Schwartz</i> , 155 U.S. 631, 636, 15 S.Ct. 237, 39 L.Ed. 289	4
<i>Kalo Inoculant Co. v. Funk Bros. Seed Co.</i> , 161 F.2d 981, reversed 333 U.S. 127, L.Ed 588	3
<i>Lewis Maeh Co. v. Aztec Lines</i> , 172 F.2d 746	3
<i>Morris Plan Industrial Bank v. Henderson</i> , 2 Cir., 131 F.2d 975, 977	4
<i>Stonega Coke & Coal Co. v. Price</i> , 106 F.2d 411, 84 L.Ed 516, 308 U.S. 618	3

No. 20472

IN THE
United States
Court of Appeals

For the Ninth Circuit

RUSSELL L. IRISH, dba
RUSSELL L. IRISH INVESTMENTS
Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION
Respondent.

PETITION FOR REHEARING

TO THE HONORABLE THE UNITED STATES
COURT OF APPEALS FOR THE NINTH
CIRCUIT:

The Petitioner herein respectfully prays for a re-
hearing en banc and a reversal of the decision of this
Court of October 19th, 1966, Cause No. 20472,
..... Fed (2d) affirming an

order of the Securities and Exchange Commission revoking the registration as a broker and dealer in securities of Russell L. Irish, expelling him from Membership in the National Association of Securities Dealers, Inc., and naming Russell Lawson Irish, Mr. Irish's son whom he employs as a salesman, as a cause of the revocation and expulsion. This Court's decision has terminated the Petitioner's right to employment, and has ended his career, upon a cold and distant record, upon charges of willful violations of anti-fraud provisions of The Securities Act, where the Hearing Examiner, who held four days of hearings in 1959, held in his written Recommended Decision of April 13, 1964, some four years later, that he could not pass upon credibility of the various witnesses (Recommended Decision, page 8), and further that it was the Hearing Examiner's opinion, during the four days of live testimony in 1959, that the Commission's case was very weak, and that it was not in the public interest to require the revocation of Mr. Irish's registration on a record that has become as stale as this.

FIRST

This action of the Commission is a death sentence of a quasi-criminal proceeding, where credibility is of outright necessity in order for any court or examiner to find the required evil intent. The examiner, who at least had held the hearing and had seen the witnesses, could not make any finding of credibility of the trial-hearing witnesses which had taken place four

years prior. Certainly to prove willfulness to violate the law, credibility is the vital issue.

The findings of the examiner, like a District Court, cannot be overturned by the Court of Appeals unless the findings are clearly erroneous, and must be reinstated by this Court on appeal unless clearly wrong. In making this examination the Court of Appeals can look only to evidence most favorable to the District Court's (Hearing Examiner's) findings. *Lewis Maeh Co. v. Aztec Lines*, 172 F.2d 746, and in determining whether a trial court's findings are clearly erroneous, due regard must be given to a trial court's opportunity to observe witnesses and judge their credibility. *Kalo Inoculant Co. v. Funk Bros. Seed Co.*, 161 F.2d 981, reversed 333 U.S. 127, 92 L.Ed. 588.

The rule that fact findings shall not be set aside unless clearly erroneous, and that master's findings shall be considered as findings of the court, should be followed in all cases, but particularly where there is a great volume of highly conflicting testimony, and the master who had *advantage of seeing and hearing witnesses is a highly trained lawyer of wide experience*. (Emphasis supplied).

Stonega Coke & Coal Co. v. Price., 106 F.2d 411, 84 L.Ed. 516

Certiorari denied 308 U.S. 618:

"... whatever may be said in favor of reversing a trial judge's findings when he has not seen the witnesses, when he has, and in so far as his findings depend upon whether they spoke the truth, the accepted rule is that they "must be treated

as unassailable." *Davis v. Schwartz*, 155 U.S. 631, 636, 15 S.Ct. 237, 39 L.Ed. 289; *Adamson v. Gillingland*, 242 U.S. 350, 353, 37 S.Ct. 169, 61 L.Ed. 356; *Alabama Power Co. v. Ickes*, 302 U.S. 464, 477, 58 S.Ct. 300, 82 L.Ed. 374. The reason for this is obvious and has been repeated over and over again; in such cases the appeal must be decided upon an incomplete record, for the printed word is only a part, and often by no means the most important part, of the sense impressions which we use to make up our minds. *Morris Plan Industrial Bank v. Henderson*, 2 Cir., 131 F.2d 975, 977."

Certainly the Commission, if fairness is the rule, must give the same credit to the findings of the examiner of this cause, or Petitioner's rights secured under the Fourth Amendment will be clearly abridged, and held to be of little value. Federal Rules Civil Procedure, Rule 52 (a) 28 U.S.C.A. spell it out insofar as trial court's findings are reviewable by a Circuit Court.

CONCLUSION

For the foregoing reasons, we request a rehearing be held or that judgment be reversed.

Respectfully submitted,

GRANT L. KIMER

RINER E. DEGLOW

Attorneys for Petitioner

925 Paulsen Building
Spokane, Washington

CERTIFICATE

WE, GRANT L. KIMER and RINER E. DEGL-
LOW, Counsel of Record for Petitioner, hereby certify
that in our judgment the foregoing Petition for Re-
hearing is well founded and that it is not interposed
for delay.

Dated this 14th day of November, 1966.

Grant L. Kimer

Riner E. Deglow

Attorneys for Petitioner.



No. 20480 ✓

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy for
HUGHES HOMES, INC., a Montana Corporation and
HUGHES HOMES ACCEPTANCE CORPORATION, an
Idaho Corporation,

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

Appellees.

BRIEF OF APPELLANT

Appeal from the United States District Court for the
District of Idaho, Northern Division

MAURICE F. HENNESSEY,
ARNOLD T. BEEBE,

Attorneys for Appellant

FURCHNER, ANDERSON & BEEBE of Counsel.

FILED

NOV 30 1965

FRANK H. SCHMID, CLERK

San Francisco Law Library

No. 20480

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy for
HUGHES HOMES, INC., a Montana Corporation and
HUGHES HOMES ACCEPTANCE CORPORATION, an
Idaho Corporation,

Appellant,

vs.

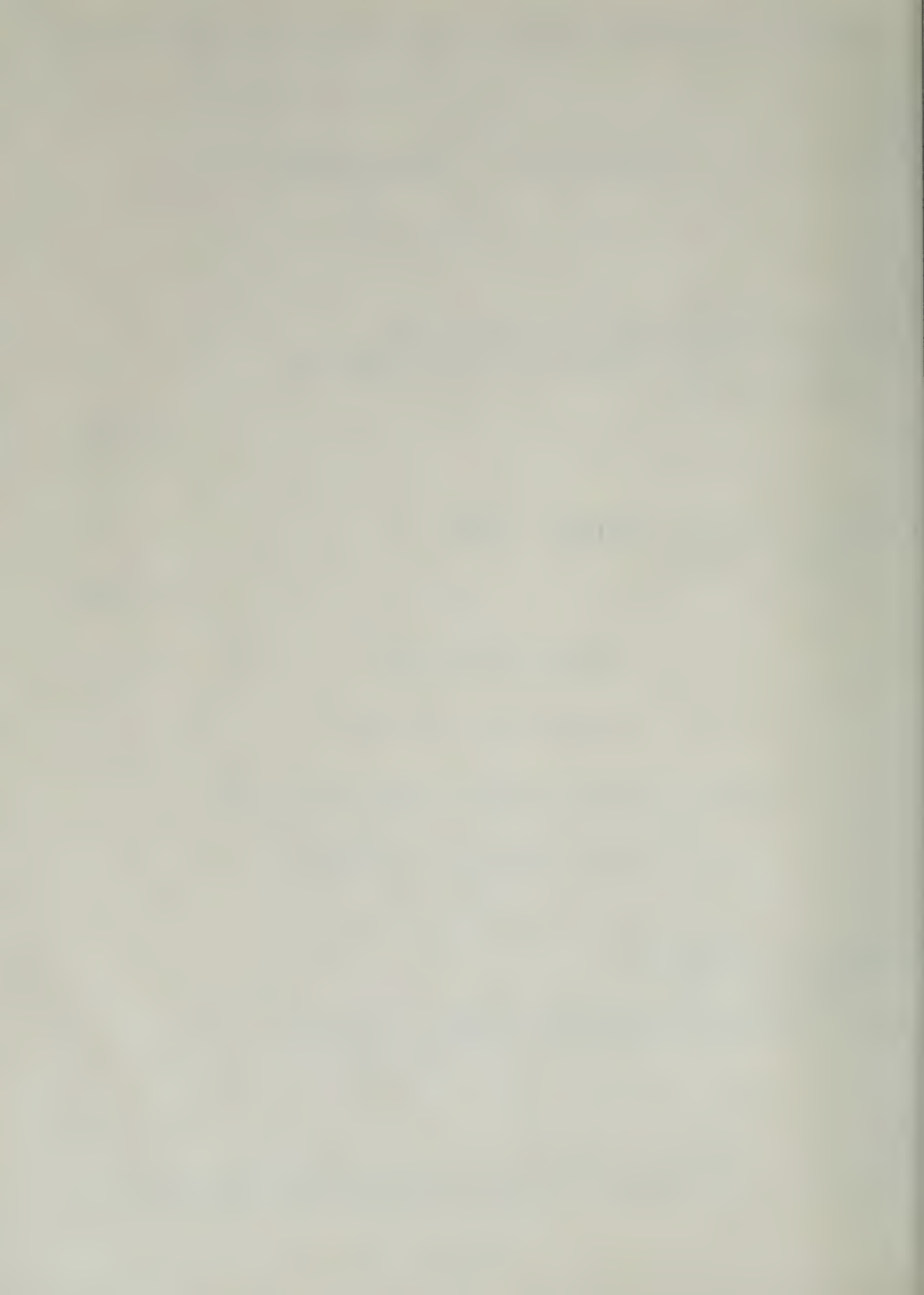
WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

Appellees.

BRIEF OF APPELLANT

Appeal from the United States District Court for the
District of Idaho, Northern Division

MAURICE F. HENNESSEY,
ARNOLD T. BEEBE,
Attorneys for Appellant
FURCHNER, ANDERSON & BEEBE of Counsel.



	Page
Jurisdiction-----	1
Statement of the Case-----	2
The Issues-----	2
Questions Involved and the Manner in Which They are Raised-----	4
The Facts-----	5
Specifications of Error-----	8
Argument-----	15
A. Conflict of Laws - Idaho (herein including Whitman v. Green, Cir 9, 1961, 289 F.2d 566---	15
B. Bad Faith or Attempt to Avoid Local Law of Usury--	19
C. Foreign Contact and Subject Matter Referable to Foreign Jurisdictions-----	23
D. Evidence of Purpose to Evade the Usury Laws of Idaho-----	24
E. Review on Appeal and Conclusion-----	38
Appendix A (Idaho Code 27-1907 (Usury))	
Appendix B (Table of Exhibits)	



	Page
125 A.L.R. 487 -----	16,17
16 Am.Jur.2d (Conflict of Laws) Secs. 39,40-----	17
91 C.J.S. (Usury) , Sec. 4 (5) , p. 562-----	17
91 C.J.S. (Usury) , Sec. 4 (6) , p. 564-----	17
91 C.J.S. (Usury) , Sec. 152-----	37
11 U.S.C.A. , Sec. 1 , et seq.-----	2
11 U.S.C.A. , Sec. 11 (20)-----	2
28 U.S.C.A. , Secs. 1291 and 1294-----	2
Idaho Code, 27-1907 (App. A)-----	36

AUTHORITIES

	Pages
Anaconda Building Materials v. Newland, Cir. 9, 336 F.2d 625-----	2,7,8
Anderson v. Creamery Package Mfg. Co., 1902, 8 Idaho 200, 67 P. 493.-----	26,27,29
Cornelison v. United States Building & Loan Association, 50 Idaho 1, 292 P. 243-----	23,25
Crawford v. Seattle R. & S. Ry. Co., 86 Wash. 628, 150 P. 1155-----	20,21,22
Easton v. Butterfield Livestock Co., 1929, 48 Idaho 153, 279 P. 716-----	29
Employees Loan Co. v. Templeton (Texas) 109 S.W.(2d) 774-----	37
Hamilton v. Bill (Texas) 90 S.W. (2d) 929-----	37
Landren v. Freeman, Cir. 9, 307 F.2d 104-----	39
Milo Theater Corp. v. National Theator Supply, 1951, 71 Idaho 435, 233 P.2d 425-----	37
Olson v. Caulfield, 1919, 32 Idaho 308, 182 P. 527-----	26,27
Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 71 L.Ed. 1123, 47 S.Ct. 626 (1927)-----	17,19,20
United States Building & Loan Association v. Lanzarotti, 1929, 47 Idaho 287, 274 P. 630-----	13,22,25,38
Utah State National Bank v. Stringer, 44 Idaho 599, 258 P. 522 (1927)-----	18,19
Vermont Loan & Trust Co. v. Hoffman, 5 Idaho 376, 49 P. 314-----	22,23,25,26



AUTHORITIES (Continued)

Whitman v. Green,

Cir. 9, 1961, 289 F.2d 566----- 15,16,19,26,38

Winters v. Swift,

2 Idaho 61, 3 P. 15 (1884)----- 18,19

Zimmerman v. Brown,

30 Idaho 640, 166 P. 924 (1917)----- 18,19,20,25



IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy for
HUGHES HOMES, INC., a Montana Corporation and
HUGHES HOMES ACCEPTANCE CORPORATION, an
Idaho Corporation,

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

Appellees.

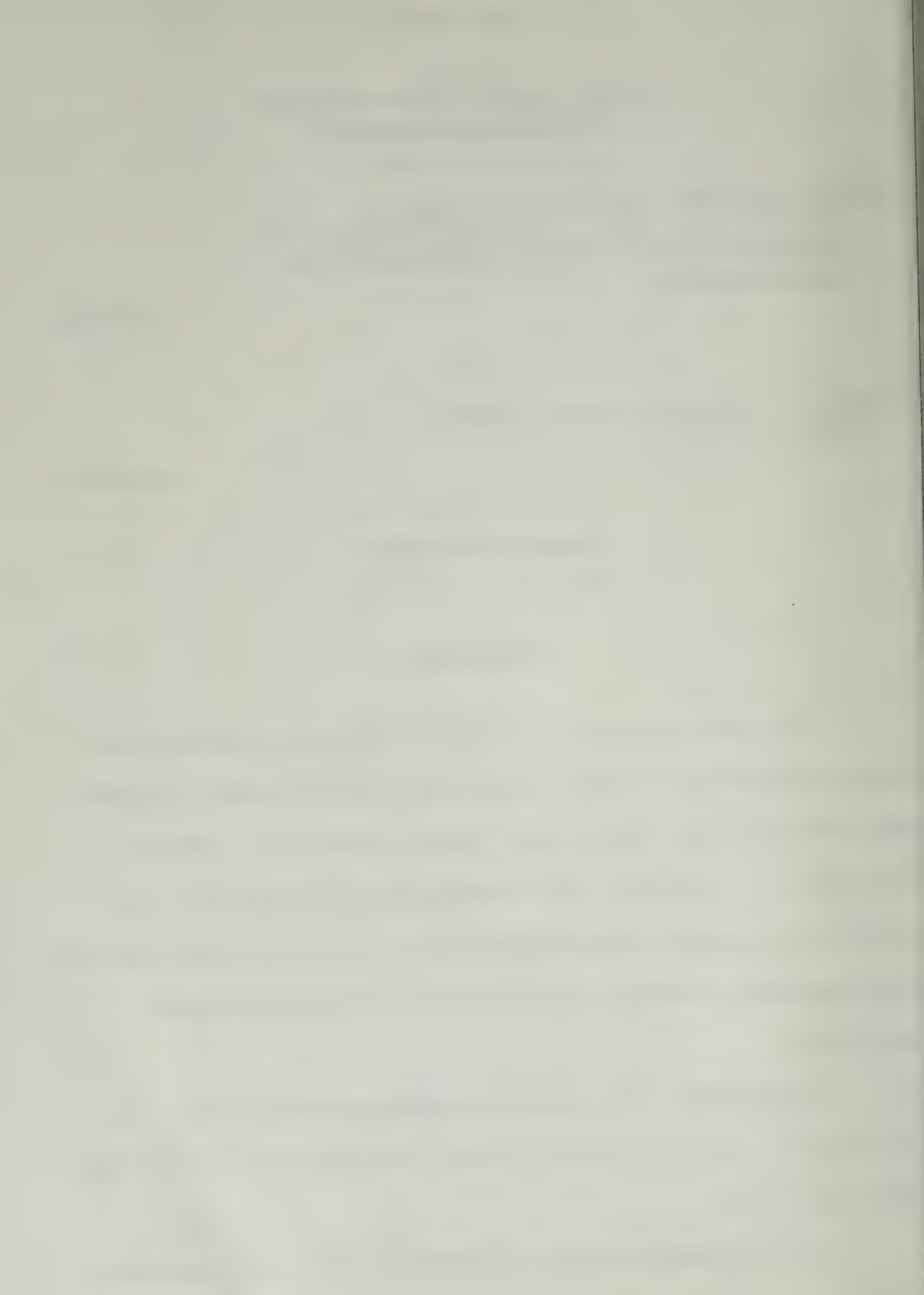
BRIEF OF APPELLANT

JURISDICTION

This action originated in the District Court of the Eighth Judicial District of the State of Idaho, in and for the County of Bonner. Plaintiffs were Wincel T. Edgar and his wife. Hughes Homes, Inc., a Montana corporation was defendant. The complaint sought to establish a note secured by a mortgage covering Idaho property as usurious and to have the same cancelled and money judgment rendered as statutory penalties (R. 10-13).

Hughes Homes, Inc., was the original mortgagee and had assigned the note and mortgage to Hughes Homes Acceptance Corporation (Def. Exs. 2 & 3).

John N. Newland was and is trustee for both of said corporations



(Anaconda Building Materials v. Newland, 9th Cir. , 336 F2d 625; R. 26).

The Trustee petitioned for removal of the cause to the United States District Court for the District of Idaho, Northern Division (R.4-6) and intervened (R.27).

The United States District Court held it had jurisdiction under the provisions of the Bankruptcy Act, 11 U.S.C.A. , Sec. 1 et seq. (R.49).

Jurisdiction of the lower court exists by virtue of 11 U.S.C.A. , Sec. 11 (20).

Judgment was entered in favor of plaintiffs and against the trustee in his official capacity for both corporations July 19, 1965, (R. 56-58) and on August 17, 1965, Notice of Appeal to the United States Court of Appeals for the Ninth Circuit was filed by the trustee.

The jurisdiction of the United States Court of Appeals for the Ninth Circuit is invoked under 28 U.S.C.A. Sec. 1291 and 1294.

STATEMENT OF THE CASE

The Issues

Appellees, Wincel T. Edgar and Helen E. Edgar, husband and wife, filed a suit in the District Court of the Eighth Judicial District of the State of Idaho, in and for the County of Bonner, against Hughes Homes, Inc., a Montana corporation, (R.10-21, 18-21) and the cause was removed to the District Court of the United States for the District of Idaho, Northern Division, upon petition for removal (R. 4-6) of John N. Newland,



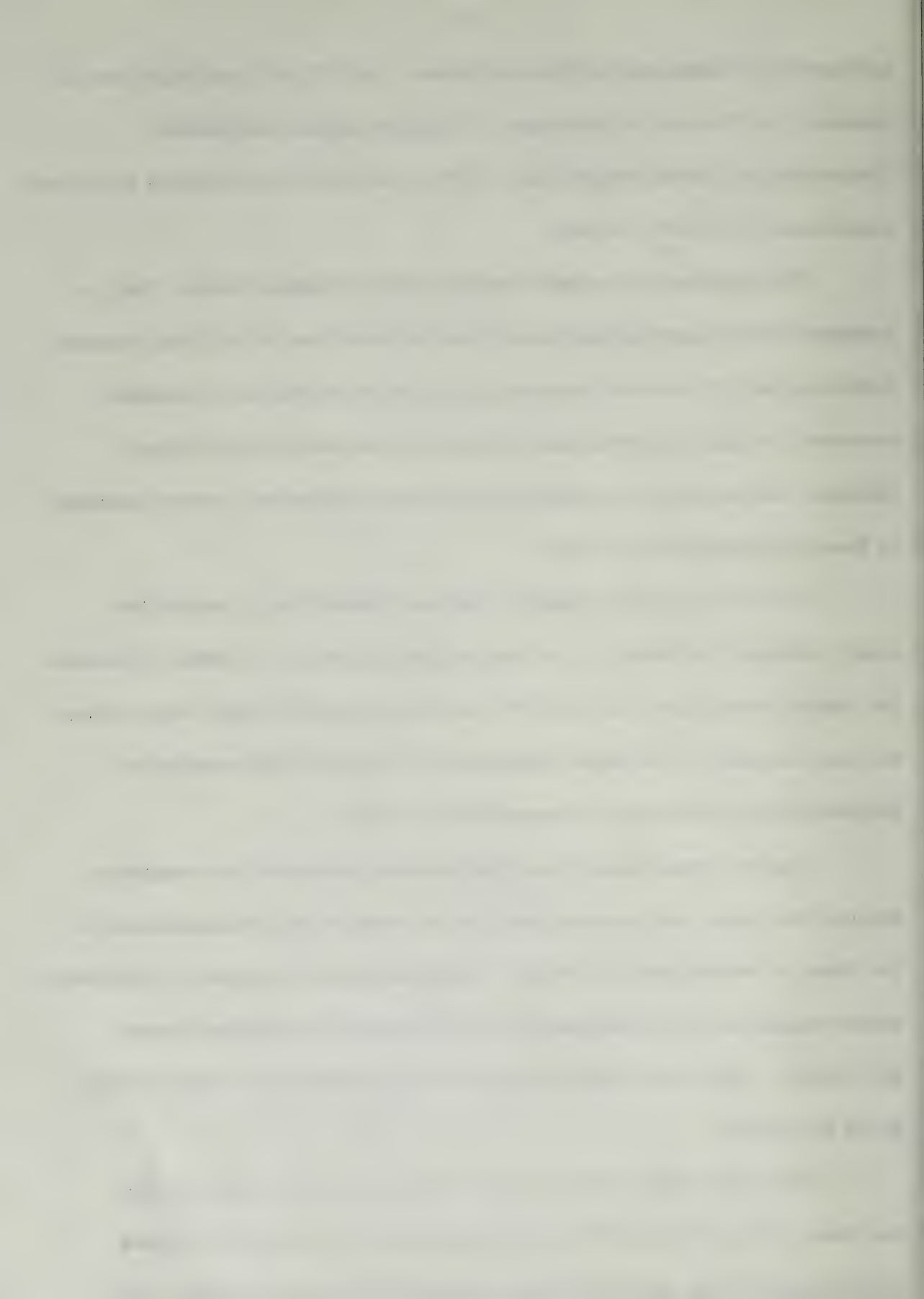
as Trustee in Bankruptcy of Hughes Homes , Inc. (R.46) , and said John N. Newland, as Trustee in Bankruptcy of Hughes Homes Acceptance Corporation,an Idaho corporation, (R.46) intervened as defendant and cross-complainant (R.25-27; 36-44).

The Appellees' complaint sought against Hughes Homes , Inc. , a judgment (based upon alleged usury and the penalties of an Idaho statute) forfeiting the 10% interest reserved, plus twice the amount of interest reserved, setting the forfeitures off against the remaining principal balance, cancelling the mortgage security and rendering a money judgment in favor of Appellees (R. 11-13).

In answer to the complaint, Hughes Homes , Inc. , denied the usury, alleged that Washington law, which permits 12% interest, governed the entire transaction, that only 8%, which is legal in Idaho, was collected and charged, and alleged assignment of the debt and security to Hughes Homes Acceptance Corporation (R. 28-30).

Hughes Homes Acceptance Corporation answered the complaint, denying the usury and averring that the transaction was accomplished in the State of Washington (R.36-38). Hughes Homes Acceptance Corporation cross-complained for foreclosure of the mortgage as assignee thereof (R. 38-44) , seeking the unpaid balance of principal and accrued interest at 8% per annum.

The cause was tried to the court sitting without a jury (R.49) , the Memorandum Opinion (R. 49-55) constituted Findings of Fact and Conclusions of law and Decree was entered in favor of appellees , the



plaintiffs (R. 56-58).

In arriving at the Decree, the Court concluded that neither Washington nor Montana law, the places of execution and performance, respectively, of the note and security instrument, were applicable (under the law of either such state, the contract would not be usurious (R.52); concluded that an intent existed to evade the usury laws of Idaho (R.54-55), and that the Idaho law with its penalty statute must be applied (R.52-53) against Newland in his capacity as trustee for both corporations (R.58).

Many of the trial court's findings of fact, the conclusions of law, and the judgment based thereon, are contended to be erroneous on this appeal.

Questions Involved and the Manner in Which
They are Raised

1. Whether appellees established by substantial evidence that:

(a) appellant attempted to evade the Idaho usury statute; and (b) the parties did not intend that Washington law should govern the transaction.

These and related findings and incidental questions are involved and result from the allegations of plaintiffs' complaint, wherein Hughes Homes, Inc., as defendant, was charged with violating the Idaho statute against usury (R. 11-13), the answer of Hughes Homes, Inc., defendant, denying the usury and alleging the transaction was governed by Washington law and alleging that only 8% interest was ever charged (R.28-31), and the answer and cross-complaint of John N. Newland, as



trustee for Hughes Homes Acceptance Corporation, which denies the usury and seeks judgment for the unpaid principal and accrued interest at 8% per annum after applying all payments first to accrued interest at 8% per annum and the balance to principal, and seeks foreclosure of the mortgage (R. 36-44).

2. Whether the conclusions of law which involve the construction by the trial court of Idaho conflict of laws rules and construction of the Idaho usury statute were erroneous, including herein claimed erroneous application of Idaho law to the transaction instead of the law of Washington or the law of Montana through Idaho conflict of laws rules; or in the event Idaho law and the Idaho usury statute properly applied to the transaction, then the erroneous application of the penalties prescribed by the Idaho statute. These and incidental questions are presented by virtue of the case being a diversity action which places in issue and calls for application of Idaho conflict of laws rules with regard to usury (R. 52-55).

The Facts

Hughes Homes, Inc., a Montana corporation, was authorized to do business in Washington, Montana and Idaho (R. 45) and had an agent, a Mrs. Edythe Nelson, a resident of Newport, Washington, a licensed realtor in Washington and Idaho, who represented the corporation in the sale of package or prefabricated homes, and who sold such a home to Edgars for Hughes Homes, Inc. (R. 48). At the time of the transaction involving the sale of a prefabricated home by Hughes Homes, Inc., to Edgars, and the financing



thereof through a note representing the purchase price and secured by a mortgage on property in Idaho, Edgars lived about 600 - 700 feet into Idaho from the Washington State line (R.Tr. 6) and from Newport, Washington, which is at the state line (R.Tr. 6), and Edgars' post office address was Box 85, Newport, Washington (Def. Ex. 4).

Mr. Edgar had previously done business with Mrs. Edythe Nelson of Nelson Realty, Newport, Washington (R.Tr. 9-10) when she sold a home for Edgars (R.Tr. 10) and when she sold them a piece of real property in Idaho (R.Tr. 10) upon which there was ultimately erected the prefabricated home which was covered by the mortgage (R.Tr. 9).

Dealings between Nelson and Edgars took place in Washington and in Idaho (R.Tr. 7, 10, 12). The contract for the sale and purchase of the prefabricated home, executed for Hughes Homes, Inc., by Edythe K. Nelson for Nelson Realty, seller, and Wincel T. Edgar, buyer, (Def. Ex. No. 4) was dated July 6, 1960, and executed at Newport, Washington (R. 46; R.Tr. 12). The contract provided that there be executed in favor of the seller a note and a mortgage or deed of trust securing the same upon the real property upon which the house was to be placed. The contract and the parties provided that delivery of the home be made at Butte, Montana (R.Tr. 12-13), which was done (R.Tr. 12-13; R. 46).

The note and mortgage were executed July 18, 1960, in a lawyer's office at Newport, Washington (R. 46; R.Tr. 7) and the obligation for which the note was issued and the mortgage securing the same given was the cash price of the package home (R. 46; Def. Ex. No. 4; R.Tr. 12).



On October 10, 1960, Hughes Homes, Inc., assigned the note and mortgage to Hughes Homes Acceptance Corporation (Def. Ex. No. 3) for valuable consideration (Def. Ex. No. 7; R.Tr. 19). John N. Newland became Trustee of Hughes Homes, Inc., and Hughes Homes Acceptance Corporation, appointed by the U.S. District Court for Montana, under Chapter X of the Bankruptcy Act, in September, 1961 (R.Tr. 14,23; Anaconda Building Materials vs. Newland, 9th Cir., 336 F2d 625). At the time of the assignment to Hughes Homes Acceptance Corporation, one payment had been made, and at the time the asset vested in the trustee, ten payments had been made (Def.Ex. 6; R.Tr. 23).

Defendant's Exhibit No. 6 is a record, originating with the first payment, showing the amount and dates of payments made, date to which interest was computed, amount of payment applied to interest and principal, and balance after such application which was kept and continued as a record of the trustee from and after September, 1961 (R.Tr.14, 18-19, 22).

Hughes Homes, Inc., Hughes Homes Acceptance Corporation and the trustee, Newland, during their respective periods of ownership or control of the note and mortgage, from the time of the first payment to the last one made, applied the payments first to accrued interest at 8% per annum and the balance to principal (R.47; Def.Ex. No.6). The application of the payments to 8% per annum interest was not communicated to Edgars (R.Tr.8).

All of the transactions of Hughes Homes, Inc., about 50 in number, involving sales of packaged homes in Idaho and notes given in payment,



secured by mortgages on Idaho property, involved interest not to exceed 8% (R.Tr. 16-18).

Interest rates of 10% in Montana, 12% in Washington and 8% in Idaho are not usurious.

SPECIFICATIONS OF ERROR

I

The trial court erred in finding that portion of Finding of Fact No. (1) as follows:

"The sole owner of the stock of the defendant, Hughes Homes, Inc., also owned all of the stock of Hughes Homes Acceptance Corporation." (R.50)

The record shows only that Hughes Homes, Inc., owned all the stock of Hughes Homes Acceptance Corporation (R.Tr.20). (See, too, Anaconda Building Materials Co. v. John N. Newland, Trustee, 9th Cir., 336 F.2d 625)

II

The trial court erred in finding that portion of Finding of Fact No. (3) as follows:

"It seems clear that Mrs. Nelson made the initial sale in the residence of the plaintiffs in the State of Idaho....." (R.50)

Negotiations for the sale of the package home took place in both Washington and Idaho between Mrs. Nelson, the realtor and agent for Hughes Homes, Inc., for sale of package homes, and Edgars (R.Tr.9-10, 12). The contract was executed in Washington (R.46; Def.Ex. 4) and the package home was delivered to Edgars in Montana (R.46; R.Tr. 12-13).



III

The trial court erred in finding or concluding that portion of Finding of Fact No. (3) as follows:

".....The execution of the note and mortgage in Washington was a mere matter of convenience and did not evidence any intent that the laws of Washington were to govern....."
(R.50-51)

".....but I am excluding any consideration of Washington law as I am satisfied the parties had no intention to be governed by the law of the State of Washington." (R.52)

"While the execution of the instruments took place in the State of Washington, this was purely for convenience and does not change the legal effect. It is certainly clear that no one expected the Washington law on interest limits to apply."
(R.54)

The execution of the note and mortgage was in fact accomplished in Washington and as a natural result of the presence there of defendant's agent as a resident of Washington and with a place of business in Washington and Edgars' habit of doing business in Washington (R.Tr. 6-7, 10). The execution of an instrument and the presence of the parties thereto in a state is a fact and has an important bearing on the intent of the parties. These matters specified are actually conclusions of law.

IV

The trial court erred in finding that portion of Finding of Fact No. (3) as follows:

"Mrs. Nelson, a licensed real estate broker in the State of Idaho, was charged with knowing the maximum legal rate of interest chargeable in Idaho." (R. 51)

Appellant is aware of nothing in the Idaho law requiring a real estate broker to know the maximum legal rate of interest chargeable, and finds nothing in the record to show that the real estate broker knew as a fact what the maximum legal rate of interest chargeable in Idaho in various transactions was.

V

The trial court erred in finding that:

"It is conceded by the parties that, if the Idaho law applied, the contract on its face is usurious." (R. 52)

A note and mortgage executed in the State of Washington, the note bearing and the mortgage securing 10% interest, in the light of the fact that the maximum legal rate of interest in Washington is 12% per annum (Def. Exs. No. 1 & 2; R. 46-47), cannot constitute a contract which is on its face usurious. Appellant does concede that the maximum legal rate of interest in Idaho is 8% per annum and that the note exceeds such maximum Idaho interest rate.

VI

The trial court erred in the following finding:

"Initially, it is conceded that a 10% charge is usurious in Idaho and that such a charge was made." (R. 54)

The note reserves 10% interest, and the record is conclusive that there was never more than 8% interest charged (R. 47; Def. Ex. 6).

THE UNIVERSITY OF CHICAGO

DEPARTMENT OF THE HISTORY OF ARTS
AND ARCHITECTURE
AND THE MUSEUM OF ART AND ARCHITECTURE
CHICAGO, ILLINOIS

1954

MEMORANDUM

TO THE DIRECTOR

FROM THE DEPARTMENT OF THE HISTORY OF ARTS

AND ARCHITECTURE

RE: [illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

NOTE

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

VII

The trial court erred in finding and concluding as follows:

"The papers were prepared by defendant's agent, who, as a licensed real estate broker, knew, or should have known, that the contract exceeded the allowable interest rate in Idaho....." (R.54)

There is no substantial evidence in the record that the real estate broker prepared the note and mortgage and there is no substantial evidence that the real estate broker knew, or should have known, what the allowable interest rate in Idaho was, or knew, or should have known, what jurisdiction governed the interest rate of the transaction. If any knowledge is chargeable to the real estate broker, it more reasonably should be that the real estate broker thought the law of Washington, the place of making, with its 12% maximum legal interest rate applied.

VIII

The trial court erred in finding or concluding as follows:

".....The defendant knew the interest to be improper as evidenced by the fact that on defendant's books the interest on each payment was charged at a rate of 8% (legal in Idaho)." (R. 54)

The charging of 8% interest does not support an inference that defendant, Hughes Homes, Inc., had knowledge that the interest rate provided by the note was improper, and on the contrary, the charging of only 8% interest negatives a corrupt intent, and supports a more reasonable inference that Hughes Homes, Inc., desired to follow a policy of uniformity among transactions which resulted in Idaho real property securing

obligations owing it.

IX

The trial court erred in the following finding:

"The plaintiffs were even charged 'late charges' for delayed payments, all based on the 10% interest amortization schedule of the contract." (R. 54-55)

This finding appears to be immaterial except as the trial judge may have felt it supported an inference of a corrupt and usurious intent. The late charges were noted to the extent of five \$1.00 charges over a period of about six months, and in fact were not collected or charged except to the extent of a few cents. (Def.Ex.6) The mortgage provided that late charges could be collected if payments were not received when due (Def. Ex. 2). The late charges noted and partially collected were all done during the time the Hughes Homes Acceptance Corporation was the owner and holder of the note and mortgage, and no corrupt or usurious intent can, in any event, be charged to Hughes Homes, Inc., the original payee and mortgagee.

X

The trial court erred in finding or concluding as follows:

"I conclude that the intent to evade the usury laws of Idaho is clearly shown." (R.55)

There is no substantial evidence that there was an intent to evade the usury laws of Idaho. To so find is clearly erroneous. To so conclude is an incorrect interpretation of the law.

XI

The trial court erred in finding and concluding as follows:

"The contract was usurious and plaintiffs are entitled to judgment. The usury penalty is to be applied." (R.55)

The note and mortgage were not usurious under the law of Washington or Montana, one of which jurisdictions is the law applicable to the transaction through the conflicts of law rules of Idaho.

If the law of Idaho was applicable to the transaction and not Washington or Montana, then the usury penalty of the Idaho statute is not applicable under the Idaho law because there was no corrupt or usurious intent, or intent to evade the law of Idaho, and because, among other reasons, though the instrument reserved 10% interest per annum, there was never any attempt to charge or collect more than 8% per annum, the maximum interest rate allowable under the Idaho statute.

XII

The trial court erred in concluding:

"That the instant case is practically on four square with...."

and controlled by the case of United States Building & Loan Association v. Lanza, 1929, 47 Ida. 287, 274 P. 630. (R.53, 55)

The conclusion that the Lanza case controls the decision in the case at bar is erroneous because the case at bar is distinguishable in many respects.

XIII

John N. Newland, both as trustee for Hughes Homes, Inc., and as trustee for Hughes Homes Acceptance Corporation.

The judgment in favor of appellees is against the facts and the law.

XIV

The court erred in rendering a judgment against John N. Newland as trustee for Hughes Homes Acceptance Corporation even if appellees were entitled to judgment against Hughes Homes, Inc.

The usury statute should not be extended to include persons not specifically enumerated therein. The note and mortgage were fair on their respective faces, and the acceptance corporation paid valuable consideration upon taking the assignment and had no notice of any usury. The statute penalizes by forfeiture the person who charges a rate of interest in the instrument in excess of the lawful rate. The statute also penalizes the person who is paid such an interest rate. The assignee did neither of these things.

Even if the forfeiture were properly held to affect the assignee through setoff against the assignee's claim as owner of the obligation, it would be error to render a money judgment in excess of any setoff which extinguishes the assignee's claim for principal and accrued interest.

XV

The trial court erred in failing to render judgment in favor of

John N. Newland, as trustee for Hughes Homes Acceptance Corporation, for the balance of the purchase price together with interest at 8% per annum and for foreclosure of the mortgage as sought in the cross-complaint.

The note and mortgage were not usurious, and as stipulated by the parties in the event the usury is not established, Hughes Homes Acceptance Corporation is entitled to judgment for \$4,510.48, plus interest thereon at the rate of 8% per annum from April 11, 1964, and attorneys fees of \$282.68. (R.47)

ARGUMENT

A. Conflict of Laws - Idaho

In Whitman v. Green 289 F.2d 566 (9th Cir. 1961), this appellate court analyzed many of the existing decisions of the Supreme Court of Idaho involving Idaho's usury statute and the conflict of laws rules involving usury.

Idaho's usury statutes are set forth in Appendix A, and provide that the taking, receiving, reserving, or charging a rate of interest greater than 8% per annum, when knowingly done, shall result in certain penalties. The statutes further provide that no indorsee in due course of negotiable paper is affected by any usury exacted by any former holder of such paper unless he have actual notice of the usury previous to his purchase.

In the Whitman case, the court **was** dealing with facts involving a loan of money by a Washington resident to an Idaho resident, evidenced by a note and secured by a mortgage on Idaho property, which instruments



were drawn in Washington, executed in Idaho and delivered in Washington. The 12% per annum interest rate of the note was legal in Washington, but not in Idaho.

In the case at bar, the obligation secured by the mortgage arose out of the sale and purchase of personal property through a contract executed in Washington (Def.Ex. 7; R.46; R.Tr. 12), the personal property was delivered in Montana (R.Tr. 12-13), the note and mortgage on Idaho property executed in Washington (R.46; R.Tr.7) and delivered either in Washington or Montana, and payable in Montana. The note provided interest at 10% per annum (Def.Ex. 1), being the legal maximum in Montana, less than the legal maximum in Washington, and more than the legal maximum in Idaho (R.47). The mortgagee, the assignee, and finally the trustee in bankruptcy, from the time the first payment was received in Montana never charged, as distinguished from reserved, and never collected more than 8% per annum, the maximum allowed under the Idaho statute. (R.47).

In the Whitman case, at the very outset of the opinion, it was stated:

"There can be little doubt but that under the weight of authority the law of Washington would be held to control in determining whether the transaction was usurious. See annotation, 125 A.L.R. 487....."

289 F.2d at 567

In view of the Whitman case decision and the reference therein to the annotation in 125 A.L.R. 487. appellant will make only brief reference

The first part of the paper discusses the importance of the study and the objectives of the research. It also outlines the methodology used in the study and the results obtained. The second part of the paper discusses the implications of the study and the conclusions drawn from the research. It also outlines the limitations of the study and the areas for further research. The third part of the paper discusses the significance of the study and the contributions it makes to the field. It also outlines the practical applications of the study and the policy implications of the research. The fourth part of the paper discusses the future of the study and the areas for further research. It also outlines the challenges faced by the study and the opportunities for future research. The fifth part of the paper discusses the conclusion of the study and the final thoughts of the researcher. It also outlines the key findings of the study and the overall message of the research.

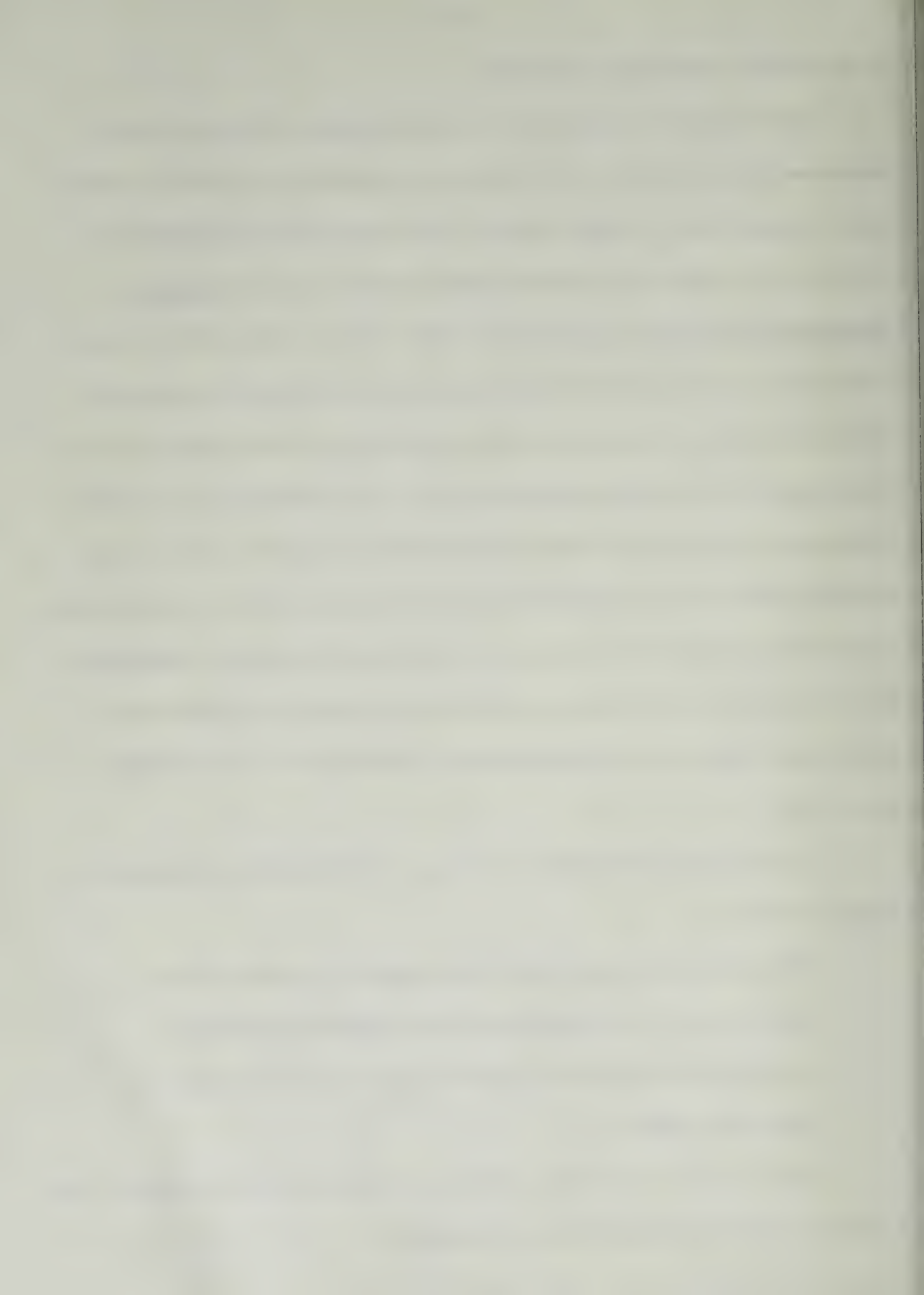
to the general principles involved.

The decisions accumulated in the annotation, 125 A.L.R. 487, disclose that the parties to a contract may expressly or impliedly intend that the usury law of a state having a vital contact with the transaction (125 A.L.R. at 482-83) or normal relation to the contract (Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 71 L.ed 1123, 47 S.Ct. 626; (1927); 125 A.L.R. at 490-91) shall apply and the laws of the place of making and place or performance are mainly the laws considered to have been implied, or by law presumed to apply, as governing the transaction (see also: 16 Am.Jur.2d (Conflict of Laws) Secs. 39, 40). Most of the decisions are concerned with the application of the law of the place which will prevent the transaction from being usurious, and mainly involve the place of making and the place of performance under one of which the transaction otherwise would be usurious (see also: 91 C.J.S. (Usury) Sec. 4 (6)).

In 91 C.J.S. (Usury) Sec. 4 (5), p. 562, the general situation is stated as follows:

"Generally, the place where the contract is made and the place where it is to be performed are important indicia in the determination of what law the parties intended should govern the contract."

In 91 C.J.S. (Usury) Sec. 4 (6), p. 564, the general rule as to presuming no intent to violate the law is stated:



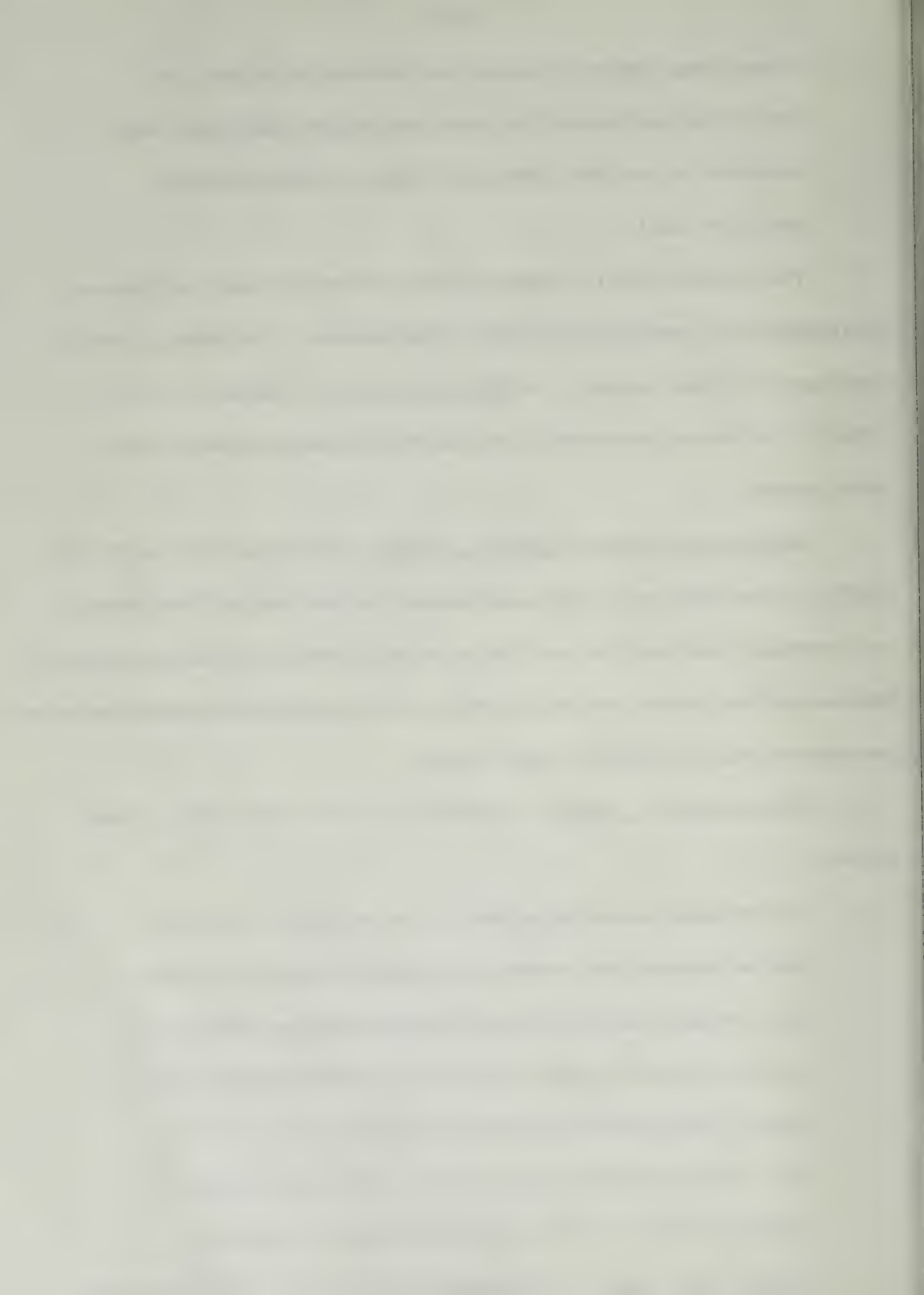
"Every presumption is against an intention to violate the law so that parties will be presumed to have contracted with reference to the law of the place wherein the transaction would be valid."

The Supreme Court of Idaho applied the law of Utah, the place of making and which was also the place of performance, involving a note and a mortgage on Idaho property, in Winters v. Swift, 2 Idaho 61, 3 P. 15 (1884). The interest rate was in excess of the amount allowed by the Idaho statute.

In Utah State National Bank v. Stringer, 44 Idaho 599, 258 P. 522 (1927), a note executed in Idaho and payable in and sent to Utah where it was accepted, was held to be a Utah note and governed by the usury law of Utah where the interest rate was lawful, and not governed by Idaho law where the interest rate violated the usury statute.

In Zimmerman v. Brown, 30 Idaho 640, 166 P. 924 (1917), it was stated:

"By the great weight of authority it is held that, in a case like the present one, every presumption is against an intention to violate the law, so that, where notes are executed in one state and payable in another, the parties will be presumed to have contracted with reference to the law of the place where the transaction would be valid rather than in view of the law by which it would be illegal, provided, however, that there is no evidence of bad faith or of an intention



to evade the usury law of the latter state, and the contract will be upheld, subject to the condition of good faith just set forth (citing cases)."

"The note in question, although made and executed in Idaho, was made payable in the state of Washington, and the fact that it purported to be dated at Wilbur, Washington shows an intention of the parties that the contract was entered into in view of the laws of that state, and, since there is neither allegation nor proof of bad faith or of an effort to evade the usury laws of this state, the note is not to be deemed usurious." (166 P. 925)

The Zimmerman case, the Utah State Bank case and the Winters case are discussed in the Whitman case. Appellant urges that these Idaho decisions and the Whitman case fully support the proposition that the law of the place of making, that is the State of Washington, or the place of performance, that is the State of Montana, and in either of which the contract would not be usurious, govern the transaction in the case at bar.

B. Bad Faith or Attempt to Avoid Local Law of Usury

At the outset in our discussion of the matters of bad faith or attempt to avoid local law of usury, qualification to the applications of the conflict of laws rules which seek to apply the law which will render the contract non-usurious, appellant presents the cautionary language of the Supreme Court of the United States, stated in Seeman v. Philadelphia Warehouse Co.,



274 U.S. 403, 71 L.Ed. 1123, 47 S.Ct. 626:

".....As thus stated, the qualification, if taken too literally, would destroy the rules themselves, for they obviously are to be invoked only to save the contract from the operation of the usury laws of the one jurisdiction or the other. The effect of the qualification is merely to prevent the evasion or avoidance at will of the usury law otherwise applicable, by the parties entering into the contract or stipulating for its performance at a place which has no normal relation to the transaction and to whose law they would not otherwise be subject....."

274 U.S. 403, at 408

The Zimmerman case, 166 P. at 925, refers to Crawford v. Seattle R. & S. Ry.Co., 86 Wash. 628, 150 P. 1155. In the Crawford case, the Supreme Court of Washington stated:

"It is well settled by the authorities that the parties to a contract may make the same with reference to the laws of any state or country and have their contractual rights governed thereby, provided only that such laws have a real, and not a mere fictitious, connection with the subject-matter of the transaction. It is enough to support this power to contract with reference to the laws of some particular state or country that some of the substantial elements of the contract have



their situs in the state or country the laws of which the parties intend to control their rights under the contract, or may be presumed from the facts and circumstances attending the making of the contract."

150 P. 1155 at 1157

The Washington court in the Crawford case continues on in its discussion and points out that if there is eliminated from consideration the cases that have as their basis an express provision in the contract evidencing the intent of the parties (150 P. at 1157), or have as their basis a situation where, as a matter of law an intention of the parties is determined because all of the elements of the contract have their situs in one state (150 P. at 1158), then the conflict in decisions as to the applicable law is more apparent than real.

The Washington court then held that:

"Where a contract might have been made by the parties thereto with reference to the laws of either one or two or more states, which contract is silent upon the subject of which laws shall govern the rights of the parties thereunder, so far as express language is concerned, and there is fair room for argument that it might have been with reference to the laws of either state, the presumption of lawful intention on the part of the makers of the contract should be controlling and result in giving the contract that construction which will



make it lawful, rather than that which will make it unlawful

....."

150 P. at 1159

The reference in the Crawford case to the intention of parties being determined as a matter of law when all of the elements of a contract have their situs in one state is, appellant asserts, an underlying basis for such decisions as Vermont Loan & Trust Co. v. Hoffman, 5 Idaho 376, 49 P.314; United States Building & Loan Association v. Lanzarotti, 1929, 47 Ida. 287, 274 P. 630. The trial court quoted in the Memorandum Opinion three paragraphs from the Lanzarotti case. The subject matter of the three paragraphs quoted gives a strong indication that one of the principal bases for the application of the Lanzarotti rule to the case at bar by the trial court is the proposition that a foreign corporation doing business in Idaho may not, whether or not it has a corrupt and usurious intent in fact, use the interest rate of its state of incorporation in a note executed by an Idaho resident. (R. 53).

Appellant has previously pointed out in this brief the existence of cases which fall in the category where as a matter of law a particular situs is held to be the governing law because all of the elements of the contract, i.e., the vital contact with the transaction, the normal relation of the elements and the parties are referable to that one situs. The Lanzarotti case is a case of that nature.

The case at bar has some elements which are common to the Lanzarotti case, and its companion cases in principle, Vermont Loan &

Trust Co. v. Hoffman, 5 Ida. 376, 49 P. 314; Cornelison v. United States Building & Loan Association, 50 Ida. 1, 292 P. 243, and those common elements are: (1) the fact that Hughes Homes, Inc., was a foreign corporation with a place of business in Idaho; and (2) a note bearing an interest rate in excess of the legal maximum under Idaho statutes and secured by a mortgage covering Idaho real property. There the similarity ends and the case at bar has elements which involve foreign subject matter, foreign contact, and conduct negating a corrupt and usurious intent and a purpose to evade Idaho law.

C. Foreign Contact and Subject Matter Referable to Foreign Jurisdictions

Appellees lived some 600 - 700 feet into Idaho from the Washington state line and from Newport, Washington, which is at the state line (R.Tr.6) and had a post office address which was Box 85, Newport, Washington (Def.Ex.4). The agent of Hughes Homes, Inc., was a resident of Newport, Washington, and maintained her office there, and the appellees had previously done business in Washington with the agent (R.Tr. 10). The basis of the transaction between Hughes Homes, Inc., and appellees was the sale by its Washington agent of a prefabricated home through a contract executed in Washington (R.46; R.Tr. 12) after negotiations in Washington and Idaho (R.Tr. 7, 10, 12). The contract provided that delivery of the package home would be made to the appellees at Butte, Montana, and this was done (R.Tr. 12-13; R. 46).

Hughes Homes, Inc., a Montana corporation, was a corporation



authorized to do business in Washington and Idaho (R.45).

If purchase of the prefabricated home was to be financed, the purchase price was to be evidenced by a note and secured by a mortgage or deed of trust covering the real property upon which the home was to be erected (Def.Ex. 4). The agent knew of the intention to erect the home on property in Idaho because in her real estate business she had sold the Idaho property to appellees and had suggested that she sell them a prefabricated home for the property (R.9). Nothing in the record indicates that Hughes Homes, Inc., actually knew where the real property upon which the home was to be constructed was located until the mortgage was executed some twelve days after the sale contract was executed (Def. Ex.4; Def. Ex. 2).

The sale of personal property was the principal aspect of the transaction, and the note and mortgage incidental. The giving of the note and mortgage was contingent upon the buyers not paying cash for the package home. The mortgage being on Idaho real property was further contingent on whether or not the package home was erected on real property in Idaho. (Def.Ex.4)

D. Evidence of Purpose to Evade the Usury Laws of Idaho

The trial court's finding or conclusion that the parties did not intend that Washington law should govern and the trial court's conclusion to exclude Washington law from consideration (R. 50-52, 54; Specification of Error No. III) were erroneous. While there is no specific statement by

the parties in the record as to what law they intended should govern, there is likewise no specific statement by the parties in the record that they did not intend that Washington law should govern. Accordingly, such facts that do appear in the record, such as: the execution of all instruments in the State of Washington (R.46); the delivery and passing of title of the prefabricated home in the State of Montana (R.Tr.12-13; Def.Ex.4); the lawfulness of the 10% per annum interest rate used by the parties under Washington law or Montana law (R.47-48); the presumption of the law to the effect that the parties intend to not violate the law; the fact that there was no discussion as to what amount of interest was involved in Idaho or in Washington (R.Tr. 11); should have led the trial court to conclude that the parties intended the law of Washington to govern their transaction.

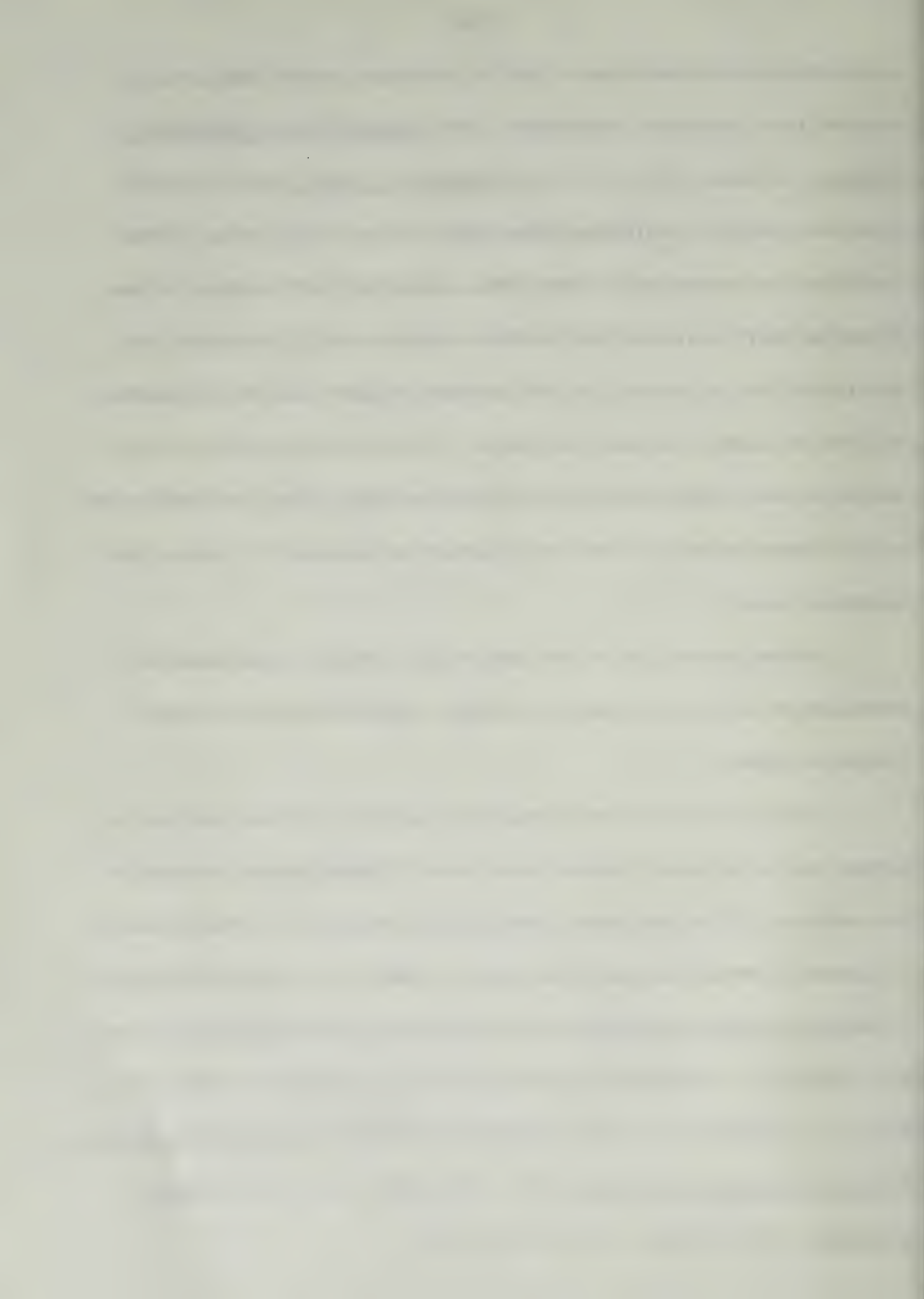
An instrument executed in Idaho, but purporting to be executed in Washington, was involved in Zimmerman v. Brown, 30 Idaho 640, 166 P. 924, and the court held that the purported dating in Washington showed an intention that Washington law was to apply.

In this connection, appellant is mindful of the Vermont Loan & Trust Co. v. Hoffman case, the Cornelison case, and the Lanzarotti case, all of which involved foreign corporations doing business in Idaho, making loans to Idaho people and securing the loans by Idaho property, the loans and mortgages being executed in Idaho bearing interest rates in excess of the Idaho statute, and the tenor of such decisions being to the effect that such a foreign corporation cannot have an innocent intent because such a

corporation would then have a right or privilege greater than could be enjoyed by a domestic corporation. (See Vermont Loan & Trust Co. v. Hoffman, 5 Idaho 376, 49 P. 319; Whitman v. Green, 289 F.2d 566) Appellant has previously discussed those cases in this brief. Under such facts as presented in those Idaho cases and with nothing further, it can be fairly assumed that the Idaho statute with its penalties will be applied and no foreign law will be held to apply and the corporation will not be heard to explain its intent. Those decisions, then, as a matter of law, under such facts exclude the inquiry that the Idaho court would otherwise make to find the presence or absence of a corrupt and usurious intent.

In the case at bar in the light of the foreign contact and the reference of the subject matter to foreign jurisdictions such inquiry should be made.

The inquiry as to the existence or not of a usurious and corrupt intent, and a purpose to evade usury laws of Idaho should be made for two reasons: (1) for the reason that in the absence of a corrupt intent or a purpose to evade the law of the State of Idaho, the law of Washington or Montana should be applied to the transaction; and (2) for the reason that should the transaction be referable to the usury law of Idaho only, then the penalties of the usury statute should not be enforced (Anderson v. Creamery Package Mfg. Co., 1902, 8 Ida. 200, 67 P. 493; Olson v. Caulfield, 1919, 32 Ida. 308, 182 P. 527).



In Anderson v. Creamery Package Mfg. Co., 1902, 8 Idaho 200, 67 P. 493, at 495, the court said:

"Under the authorities above cited, can it be said that John A. Anderson and Mattie Vass knowingly and corruptly entered into the contracts the notes and mortgages with the intent to collect a rate of interest that would be usurious under our statute? We think not." (emphasis added)

The Anderson case quotes the following in the opinion at page 495;

"In Association v. Stanley (Or.) 63 Pac. 495, it is said:

'But notwithstanding the contract appears to be usurious on its face, and the natural inference to be drawn therefrom is that the parties intended the result of their own acts, yet there is another element which must attend the practice of usury. It must be with a corrupt intent, which means that the parties must have knowingly agreed upon a rate of interest greater than that allowed by law. But where they have acted under an honest belief that the stipulated rate was recoverable under the law, in which they were mistaken it has been held that the penalties of usury would not be enforced." (emphasis added)

In Olson v. Caulfield, 1919, 32 Ida. 308, 182 P. 527, at 32 Ida. 312, it is stated:

"It is also true that: When a contract on its face discloses no

appearance of usury, it is presumed to have been made in good faith. And it is for the party who alleges that a corrupt and usurious intent lurks behind such a contract to prove the truth of his allegation." (39 Cyc. 1052; 13 C.J. 779) (emphasis added)

"The law requires that all the facts constituting usury should be proven with reasonable certainty. And evidence which creates in the mind nothing further than a mere surmise, suspicion, conjecture or doubtful inference that the transaction is usurious, or which is intrinsically improbable, is insufficient." (39 Cyc. 1054; 13 C.J. 779)

"The fact at issue in such cases may be determined by inference from all the surrounding circumstances of the case, tending to show the real intent of the parties and the true nature of the transaction in question. Every fact and circumstance in evidence in this case, other than the testimony above quoted as to a conversation had, if at all, some time prior to the actual consummation of the contract, argues strongly against any usurious element in the transaction. Respondent had carried the first loan for nearly five years without collecting any interest. Notwithstanding this, he paid out additional money for taxes on the property, paid up a number of deceased's outstanding obligations, loaned him additional money, and took



a second mortgage on the property. There is certainly nothing which can be gleaned from these circumstances which would indicate any intention on the part of respondent to take any illegal advantage of the deceased."

In Easton v. Butterfield Livestock Co., 1929, 48 Idaho 153, 279 P.

716, the court considered as an important fact bearing on the question of existence of a corrupt intent, the fact that no effort was made to collect illegal interest.

"To constitute usury it is necessary that the excessive interest be 'knowingly' taken, received, reserved or charged. (C.S., Sec. 2553; Anderson v. Creamery Co., 8 Ida. 200, 101 Am.St. 188, 67 P. 493, 56 L.R.A. 554; 2 Page on Contracts, Sec. 964, p. 1708.) When we consider that the opportunity of exacting excessive interest was postponed for the period of more than nine years from the date of the contract, that no effort was made to collect illegal interest, the improbability of the bondholders waiving defaults for nine years in order to collect such interest and that the bonds were offered for sale and sold by the livestock company after it had either prepared or approved the contract, we cannot say that the contract discloses a corrupt intention on the part of the bondholders to knowingly take, receive, reserve or charge interest at a rate in excess of ten per cent per annum and that all interest earned shall be forfeited



and all payments made applied to the payment of principal."

(emphasis added)

279 P. 716, 719

Specifications of Error IV, VII, VIII and IX involve findings or conclusions pertaining to knowledge or imputed knowledge relative to the Idaho usury statute, knowledge or imputed knowledge that the Idaho usury statute was applicable to the transaction, and interest and late charges made. Such findings appear to be the crux of the trial court's basis for finding or concluding there was an intent to evade the Idaho law.

The trial court's finding that:

"the papers were prepared by defendant's agent, who, as a licensed real estate broker, knew, or should have known, that the contract exceeded the allowable interest rate in Idaho....." (R.54; Spec. of Error VII)

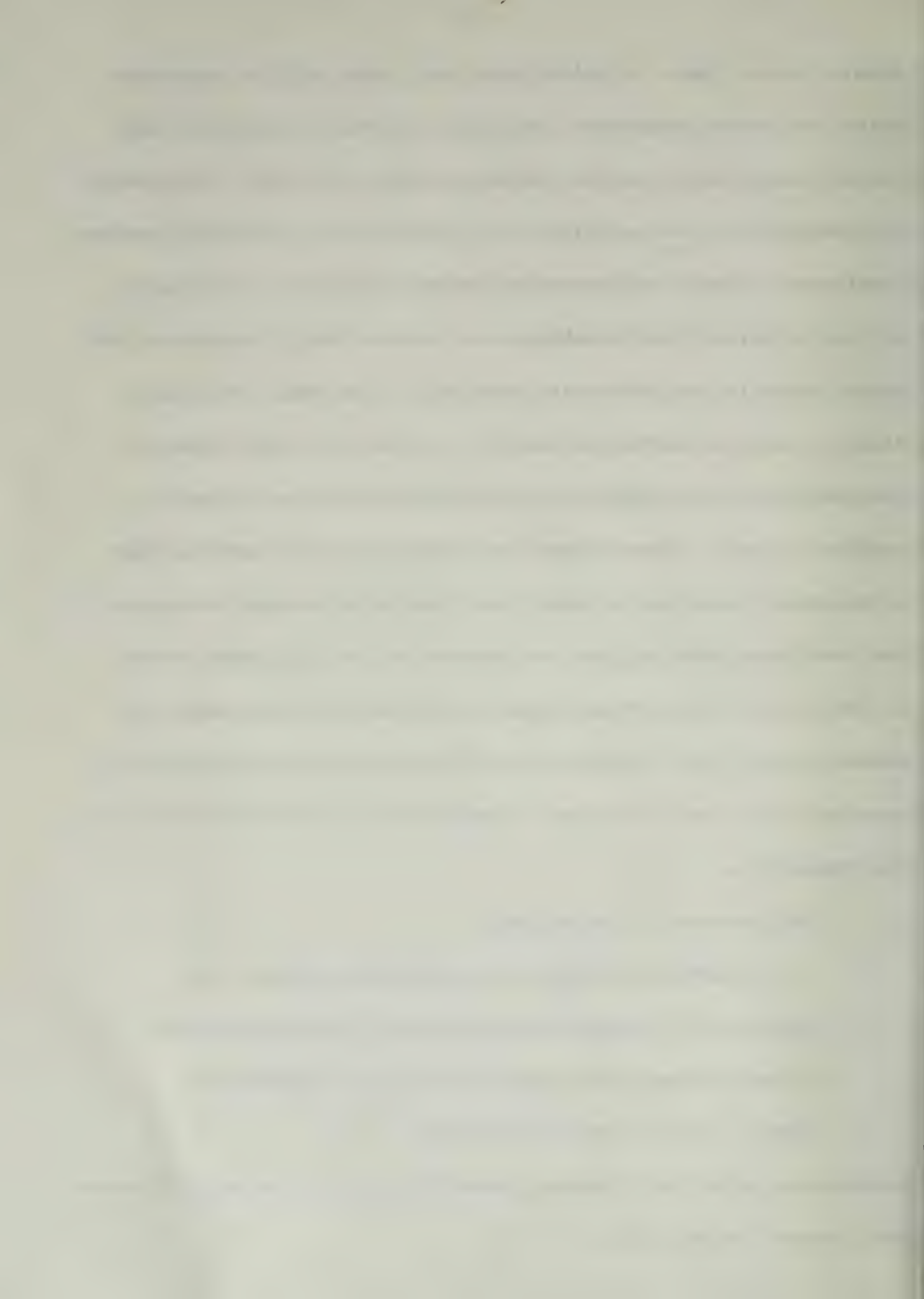
to the extent it refers to the note and mortgage, as distinguished from the contract for the sale of the package home, is not supported by the record. Appellant does not argue that Hughes Homes, Inc., is not chargeable with causing the note and mortgage to be prepared. Under the state of the record it is just as reasonable to guess that the attorney in Washington drew the instruments (R.Tr. 7). The finding that the real estate broker prepared the papers (note and mortgage) seems to have been made to make material the further finding that the real estate broker knew or should have known that the contract exceeded the allowable

interest rate in Idaho. Appellant does not quarrel with the proposition that a real estate broker more likely than not knew the maximum legal rate of interest which may be charged generally in a state, but appellant is unaware of any law requiring a real estate broker to know the maximum legal rate of interest which may be charged and nothing in the record is found to support that knowledge as a matter of fact. Assuming a real estate broker is chargeable with knowledge of the usury statute of a state, it does not follow from that fact that the real estate broker is chargeable with knowledge of the intricacies of the law involved in conflict of laws. If there be any implication as to the knowledge that a real estate broker has or should have relative to a usury statute and the law of what state applies to a transaction, the implication would be that the real estate broker would have in mind the most general or common rules, that is, that the law of the place where instruments are executed or the law of the place of performance of a contract will govern the transaction.

The trial court's finding that:

".....Defendant knew the interest to be improper, as evidenced by the fact that on defendant's books the interest on each payment was charged at the rate of 8% (legal in Idaho)." (R.54; Spec. of Error VIII)

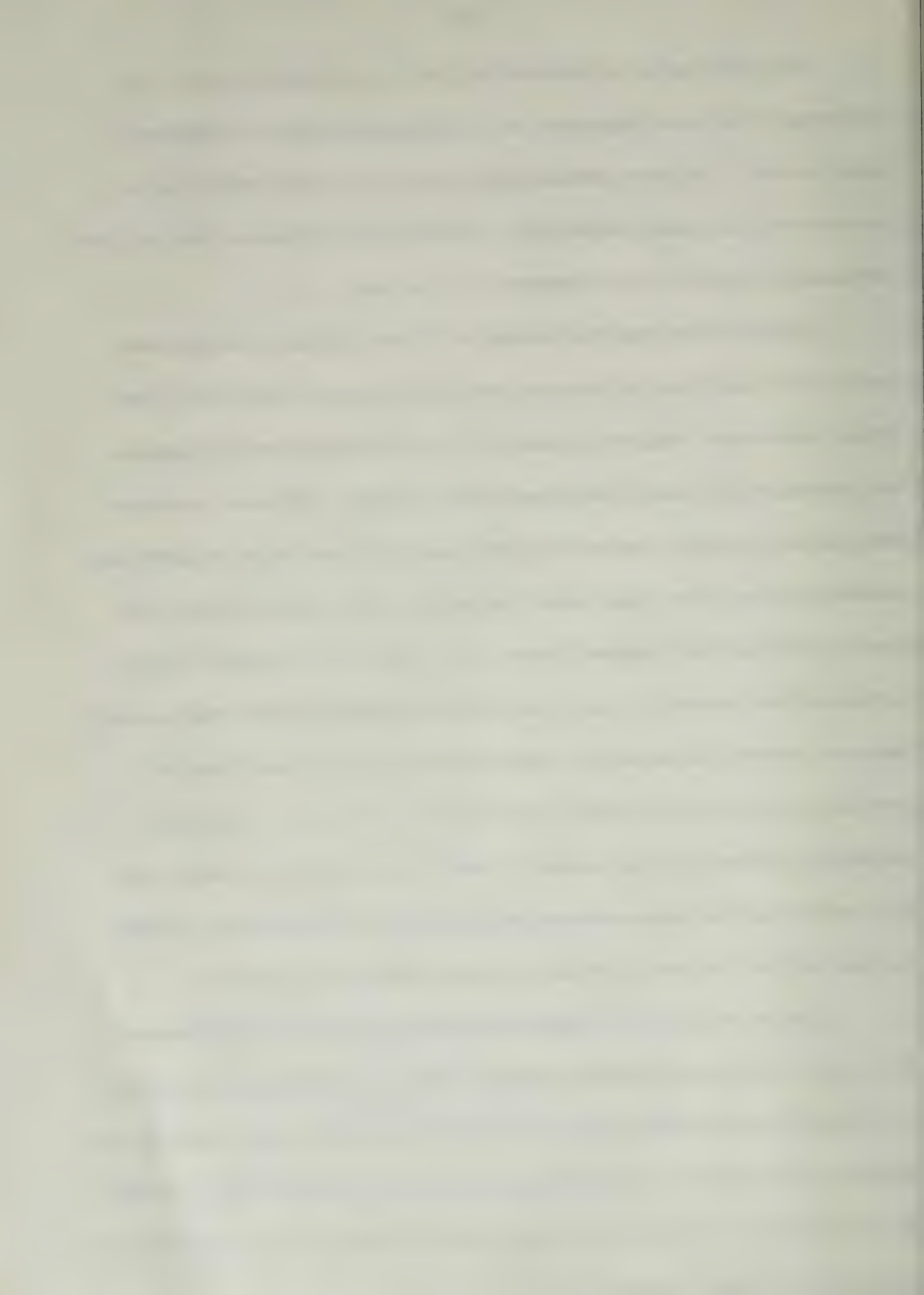
involves an unjustified inference drawn from the fact that only 8% interest was charged and collected.



Appellant does not contest the fact that Hughes Homes, Inc., is charged with knowledge that the maximum legal rate of interest in Idaho was 8%, but does contend that at the time of the execution of the note and mortgage transaction, or thereafter, defendant did not know the interest reserved to be improper or usurious.

The fact that from the inception of the payments, which was two or three months after the mortgage was executed (Def.Ex.6), and before which time Hughes Homes, Inc., had unquestionably received the mortgage and note at the home office in Butte, Montana, and was then unquestionably chargeable with knowledge that Idaho property was involved as security, there was charged only 8% interest (and in the light of the fact that Hughes Homes, Inc., had not, in some 50 transactions where package homes were sold in Idaho and Idaho real property became involved as security, exceeded the maximum legal rate of interest provided by the Idaho statute (R.Tr. 17-18, 21)) forcefully negatives any bad faith or intent to evade the usury law of Idaho and it is urged that the only reasonable inferences or conclusions are that no bad faith or purpose to evade the law of Idaho ever existed.

The reserving of 10% interest, with 12% lawful in Washington, 10% lawful in Montana and 8% lawful in Idaho, and the actual charging of 8% from the time of the very first payment suggests many possibilities but does not amount to substantial evidence of, or even tend to support, an inference or conclusion that there was a corrupt intent or a purpose to evade Idaho's usury statute.



More reasonably suggested is that when the sale of personal property transaction culminated in mortgage security in Idaho, and the note and mortgage were received at Butte, Montana, the corporation desired to treat the Edgar mortgage the same interest-wise as the 50 transactions which Hughes Homes, Inc., had consummated in Idaho, which involved sales actually made in Idaho, of prefabricated homes with Idaho mortgages resulting (R.Tr. 17-18, 21).

Another finding which appears to be in part a basis for the finding or conclusion that there was an intent on the part of Hughes Homes, Inc., to evade the usury laws of Idaho is as follows:

"Plaintiffs were even charged 'late charges' for delayed payments all based on the 10% interest amortization schedule of the contract." (R.54-55; Spec. of Error IX)

The late charges were noted on defendant's exhibit 6, and were only partially assessed. The notations of late charges and partial assessment of the noted late charges was done by Hughes Homes Acceptance Corporation, the assignee. The assignment was made October 10, 1960 (Def.Ex.3) and the trustee was appointed in September, 1961 (R.Tr.23).

Appellant is aware of no other part of the record than defendant's exhibits 2 and 6 pertaining to the late charges. The mortgage, (Def.Ex.2) contains a provision enabling the mortgagee at its option to make a late charge in the event of delayed installment payments. Defendant's exhibit 6 discloses that on five occasions between the dates March 20,

1961, and October 2, 1961, late charges were noted. The five payments credited at \$71.37 each as received from March 20, 1961, to and including October, 1961, were actually \$72.37 each (See checks No. 107, 105, 133, 148, 169 of Pl. Exs. 8, 9). However, the total of each payment, \$72.37, was credited between the interest column, which would include any late charge assessed, and the principal column. A computation of the interest chargeable at 8% per annum during said period approximates within cents the sum of \$256.00, and there was in fact charged during said period as interest and late charge the sum of \$256.25.

The finding is clearly erroneous to the extent it purports to find that late charges involved were other than a matter of a slight amount of money, to the extent it purports to attribute the assessment of late charges to other than the provision of the mortgage providing for the same or to some corrupt and usurious intent.

The following:

"It is conceded by the parties, that if Idaho law applies, the contract on its face is usurious." (R.52; Spec. of Error V)

and

"The sole owner of the stock of the defendant, Hughes Homes, Inc., also owned all of the stock of Hughes Homes Acceptance Corporation." (R.50; Spec. of Error I)

appear to be material only as they may be necessary to support the judgment against the trustee in his particular capacity as trustee for Hughes

Homes Acceptance Corporation, functioning to charge such assignee with actual or imputed knowledge of usury. (R.58; Spec. of Error XIV).

Appellant contends that a note and mortgage, dated and executed in Washington, carrying 10% per annum interest, the mortgage covering Idaho property, cannot be usurious on its face, even though a court may subsequently determine from the whole transaction that usury was involved. The instruments themselves, not being usurious on the face would give no actual notice of usury to a transferee. There is no evidence in the record to support a finding that the owner of the stock of Hughes Homes, Inc., also owned all of the stock of Hughes Homes Acceptance Corporation; though the record does show that Hughes Homes, Inc., did own all of the stock of the acceptance corporation (R.20; See also: Anaconda Building Materials Co. et al v. John N. Newland, Trustee, Cir. 9, 336 F.2d 625). In the Anaconda Building Materials Co. v. Newland case, this appellate court affirmed the bankruptcy court's instructions to this trustee that the assets of Hughes Homes Acceptance Corporation may not be used to satisfy the claims of the creditors of Hughes Homes, Inc. It was further held in that case that:

"The executive vice-presidents (of the Acceptance Corporations, including the Idaho Acceptance Corporation) acted independently in the acceptance and approval of mortgage securities,....." (parenthetical added)

The record shows that Hughes Homes Acceptance Corporation was the assignee of the note and mortgage (Def.Ex.3) for valuable consideration. (R.Tr.19) The note and mortgage were fair on their respective faces.

The usury statute (Appendix A) provides that:

"The taking, receiving, reserving, or charging a rate of interest greater than is allowed by this chapter, when knowingly done, shall be deemed a forfeiture by the person so taking, receiving, reserving or charging to the benefit of the person paying or being charged, of the entire interest which the contract carries with it or which has been agreed to be paid thereon, plus twice the amount of such interest...."

The statute then continues:

"In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back the amount of the interest thus paid from the person taking or receiving the same, plus twice the amount of such interest in addition. No indorsee in due course of negotiable paper is affected by any usury exacted by any former holder of such paper unless he have actual notice of the usury previous to his purchase."

The statute, being quasi penal and providing for forfeiture will not be construed to include matters or persons not expressly enumerated

therein (See: Milo Theater Corp. v. National Theater Supply, 1951, 71 Idaho 435, 233 P.2d 425, at 429). The provision of the statute that an indorsee of negotiable paper is unaffected by any usury exacted by a former holder of such paper unless he have actual notice of the usury previous to his purchase, does not by such express exclusion of an indorsee include in all events an assignee.

The statute does not make the instrument void, and as to an assignee who has not taken or received usurious interest the penalties cannot be enforced (Milo Theater Corp. v. National Theater Supply, 1951, 71 Idaho 435, 233 P.2d 425; Hamilton v. Bill (Texas) 90 S.W. (2d) 929; See: Employees Loan Co. v. Templeton (Texas) 109 S.W. (2d) 774; 91 C.J.S. Sec. 152).

The Idaho statute makes provision for the forfeiture by the person who takes, receives, reserves or charges a rate of interest of the entire interest the contract carries with it or which has been agreed to be paid, plus twice the amount of such interest. If there were usury, Hughes Homes, Inc., would be the party designated in the portion of the statute that would suffer the forfeiture for reserving the rate of interest.

The Idaho statute also makes provision for a penalty to be suffered by the person to whom usurious interest has been paid. Neither Hughes Homes, Inc., nor Hughes Homes Acceptance Corporation were paid usurious interest. (R.47).

If the forfeiture by the payee-mortgagee is deemed to affect the



assignee, which appellant urges is not the law, in any event, there is no legal basis for rendering judgment against the assignee over and above setting off the forfeiture against the claim of the assignee.

E. Review on Appeal and Conclusion

The entire proceedings in this case were submitted to the trial judge upon an agreed statement of facts (R.45-48), the testimony of Wincel T. Edgar (R.Tr.6-13), the testimony of John N. Newland, the trustee (R.Tr.14-23), and the exhibits.

The record is substantially documents or agreed facts, and the slight amount of testimony is undisputed and pertains mostly to facts disclosed by the exhibits or agreed upon. There should be no substantial issue as to the credibility of witnesses.

The trial judge made it very clear in his Memorandum Opinion (R.53,55) that the Lanzarotti case controlled his decision. As appellant has urged, the Lanzarotti case is one wherein it was virtually held as a matter of law that a foreign corporation cannot loan money in Idaho, and reserve and collect interest in excess of the statutory maximum. The Whitman decision of this appellate court indicated to the trial judge that to apply the Lanzarotti rule there must be found both a doing of business in the State of Idaho and a purpose to evade Idaho's usury law. (R.54)

Appellant contends that the true basis of most of the "findings" of the trial judge that this transaction was a doing of business in Idaho



(in the sense that the same excluded consideration of the foreign nature of the transaction) and that there was a purpose to evade Idaho law were inferences drawn from legal standards and erroneously so drawn.

"In all these cases the inferences drawn from the undisputed facts seem to have been inferences derived from application of a legal standard and not inferences derived from having had 'experience with the mainsprings of human conduct'."

Lundren v. Freeman, Cir. 9,
307 F.2d 104, at 115

The conclusions of the trial judge based on application of a legal standard need be given no weight (Lundren v. Freeman).

The finding as a fact that the parties did not intend that Washington law governed the transaction is clearly erroneous. The finding that there was a purpose to evade the Idaho usury law is clearly erroneous. It was error to conclude that Washington or Montana law through Idaho conflict of laws rules did not govern the transaction and to conclude that the transaction was usurious.

It is submitted that the judgment against John N. Newland in both his capacities as trustee for Hughes Homes, Inc., and Hughes Homes Acceptance Corporation should be reversed and that judgment should be rendered on behalf of John N. Newland as trustee for Hughes Homes Acceptance Corporation for the balance of the obligation on the note, and foreclosure proceedings.



Respectfully submitted,

MAURICE F. HENNESSEY
Butte, Monana

ARNOLD T. BEEBE
Blackfoot, Idaho

Attorneys for Appellant

FURCHNER, ANDERSON & BEEBE
Blackfoot, Idaho
Of Counsel

I certify that, in connection with the preparation of this brief,
I have examined Rules 18 and 19 of the United States Court of Appeals
for the Ninth Circuit, and that, in my opinion, the foregoing brief is in
full compliance with those rules.

Arnold T. Beebe, Attorney



Idaho Code 27-1907. Usury -- Charging -- Penalty -- Indorsee

in due course, exception. -- The taking, receiving, reserving, or charging a rate of interest greater than is allowed by this chapter, when knowingly done, shall be deemed a forfeiture by the person so taking, receiving, reserving or charging to the benefit of the person paying or being charged, of the entire interest which the contract carries with it or which has been agreed to be paid thereon, plus twice the amount of such interest. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back the amount of the interest thus paid from the person taking or receiving the same, plus twice the amount of such interest in addition. No indorsee in due course of negotiable paper is affected by any usury exacted by any former holder of such paper unless he have actual notice of the usury previous to his purchase.

EXHIBITS

		<u>Marked</u>	<u>Admitted</u>
Defendant's Exhibits 1, 2 and 3	R.Tr.	2	3
Defendant's Exhibit 4	R.Tr.	3	5
Defendant's Exhibit 5	R.Tr.	3	5
Defendant's Exhibit 6	R.Tr.	3	5
Defendant's Exhibit 7	R.Tr.	3	5
Plaintiff's Exhibits 8 and 9	R.Tr.	5	5

No. 20480

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy
for HUGHES HOMES, INC., a Montana
Corporation, and HUGHEST HOMES ACCEP-
TANCE CORPORATION, an Idaho corporation

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
husband and wife,

Appellees.

BRIEF OF APPELLEE

Appeal from the United States District Court
for the District of Idaho,
Northern Division

STEPHEN BISTLINE
Attorney for Appellees
101 N. First Avenue
Sandpoint, Idaho

FILED

DEC 29 1965

FRANK H. SCHMIDT, CLERK

TEXTS AND STATUTES

le 52 (a) Federal Rules of Civil Procedure.	16
-1907 Idaho Code	27, 29, 30
-105 Idaho Code	28
Am Jur 38-40	29

INDEX

Preface.	1
Statement of the Case	2
Appellants' Concessions13
Intentions of Appellants.15
Argument.18

AUTHORITIES

Seconda Building Material v. John	
Newland, 1964, 336 F2d 625	4
arnelison v. United States Building	
d Loan Association, 1930, 50 Idaho 1,	
0 P. 1155	26, 30, 31
ndgren v. Freeman, 1962, Ninth Circuit	
7 F2d 104	16, 17, 24, 25
nford v. Kunz, 9 Idaho 29,	22, 23
Pac 612	
ited States Building and Loan	
sociation v. Lanzarotti, 1929,	
Idaho 287, 274 P. 630-632-----1, 11, 12, 26	
rmont Loan and Trust Co. V. Hoffman,	
97, 5 Idaho 376, 49 Pac 314, 95 Am	
e Rep. 186, 37 LRA 509.	18
ltman v. Greene, 1961, 289 P2d,	
5.	1, 11, 13, 18
mmerman v. Brown, 1917, 30 Idaho 640	
5 Pac 924	12, 24

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy
of HUGHES HOMES, INC., a Montana
Corporation and HUGHES HOMES ACCEPTANCE
CORPORATION, an Idaho Corporation ,

Appellant,

vs.

WENDEL T. EDGAR and HELEN E. EDGAR,
Husband and wife,

Appellees,

BRIEF FOR APPELLEE

In this diversity action, the appellant
corporations have urged that the United States
District Judge did not correctly apply the
Lanzarotti rule, United States Building
and Loan Association v. Lanzarotti, 1929,
Idaho 287, 274 P. 630-632, which Lanzarotti
was thoroughly analyzed and discussed by
the United States Circuit Court of Appeals,
Ninth Circuit in the Whitman case, Whitman v.
Keene, 1961, 289 P.2d 566.

STATEMENT OF THE FACTS

Appellees, residents of Idaho, and the
mortgagors herein, brought action for cancell-
ation of an allegedly usurious note and mortgage,
and for judgment for penalty under the Idaho
usury statute. Appellees named as party defend-
ers to their action Hughes Homes, Inc., a
Montana corporation, to which the note and
mortgage were made payable. This corporation,
which will be referred to herein as the Mont-
ana corporation, appeared generally in the
action, being represented by John N. Newland,
Trustee, appointed by the United States District
Court in Montana bankruptcy proceedings.
Hughes Homes Acceptance Corporation, an Idaho
corporation, also represented by the same
John N. Newland as its Trustee in bankruptcy pro-
ceedings, appeared generally in the action,

and sought leave of the court to be joined as party defendant. By stipulation, Transcript page 26, Order was entered bringing this Idaho corporation in as a party defendant. Being the only Idaho corporation herein involved, it will be referred to herein as the Idaho corporation.

The Idaho acceptance corporation alleged the assignment to it of the note and mortgage involved, and sought foreclosure of the same.

The note and mortgage called for interest at the rate of 10% per annum, usurious as against the legal maximum in Idaho of 8%.

The Montana corporation defended against appellees' claim on two grounds: that the

tire transaction out of which the obligation secured by said note and mortgage arose, took place in the state of Washington, and is controlled by Washington, and; that in fact only 8% interest was collected and charged the appellees.
p. 30.

The Idaho corporation, in its Answer and cross-complaint, alleged: that all of the notes, debts and obligations evidenced by said note and secured by said mortgage were contracted for, consummated and executed in the state of Washington.

Appellants, at the trial, Rep. Tr. p. 20, and in their brief, have invited attention to Anaconda Building Materials v. John N. Newland, 1964, 336 Fed 2d 625, which involved the same parent Montana corporation, the same Idaho acceptance corporation, and three other subsidiary corporations, one in Washington, one of Wyoming, and one of

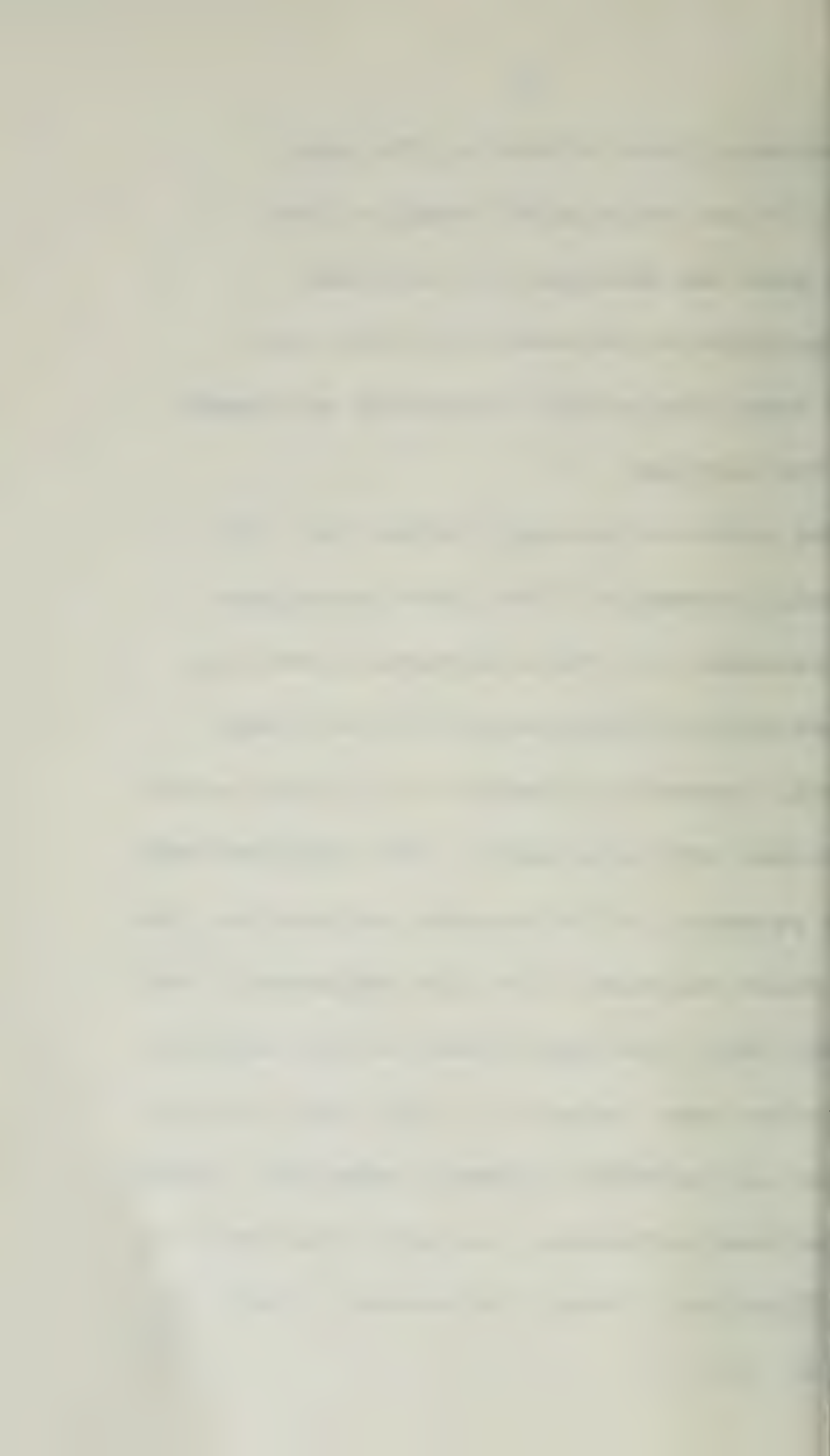
ntana. In that case it was held by the
rcuit Court of Appeals that all of the
ve corporations of the Hughes enterprise
re separate entities, and noted that each
bsidiary was totally owned by the parent
ntana corporation. It was also noted that
. C. Hughes, Jr., was president of each
rporation, dominating and mismanaging
e entire enterprise

The note and mortgage involved encumbered
aho real property owned by the appellees,
d both are exhibits to appellants' plead-
gs, and in evidence. Also placed in evidence
the assignment by which the Idaho corporation
quired the mortgage. Defendant's Exhibit
. 3.

The assignment was never recorded. No assign-
nt of the note seems to appear, but the
signment of the mortgage states "together
th the obligation thereby secured and the

omissory Note evidencing the same,"
d, it was stipulated formally that
e note was assigned to the Idaho
orporation on October 10, 1960, also
e same date as the unrecorded assignment
the mortgage.

The note and mortgage called for 120
nthly payments. The Idaho acceptance
orporation, by the assignment, came into
nership of the same with 119 of these
nthly payments, computed at 10% per annum
terest, yet to be made. The appellees made
o payments to the Montana corporation, one
which was made after the assignment, and,
en, until the appointment of Mr. Newland,
de ten more payments to the Idaho corpora-
on, all of which payments were sent by the
pellees to Montana, and were then sent on
Blackfoot (Idaho) for deposit. Rep. Tr.
21, 1. 7.



The note was made payable at Butte, Montana, and on a ten-year basis of 120 monthly payments, to retire \$5,445.30, together with the stated interest of 10%, required payments of \$71.37 per month. Any bank amortization schedule will confirm that \$71.37 per month is required to retire \$5,445.30 in ten years at ten per cent. It was formally stipulated to by the corporations that as payments were received, a monthly receipt was sent to the plaintiffs (appellees) showing the application of payments received to principal and interest." And, at the trial Mr. Edgar, appellee, testified that there was never a time after he and Mrs. Edgar began making payments that they were given any advice from either corporation as to what rate of interest was being computed at, or but what they would be making the 120 payments required by them. Rep. tr. p. 8, lines 8-21.

It was formally stipulated to that the Montana corporation's agent for this transaction here involved was also a realtor licensed to do business in both Idaho and Washington, with a residence and only office in Newport, Washington. And also formally stipulated that the appellees were Idaho residents, and the nearest city to their residence was the town of Newport, Washington. It was testified to by Mr. Edgar, without contradiction, that the "dealing" primarily took place at appellee's home in Idaho, and the signing of the papers was in Newport, and that Mr. Jones, the notary to the mortgage, did no part in the transaction other than to act as notary. Rep. tr. p. 7, l. 19-25; 18, l. 4-7

The U. S. District Judge found against the contention of appellants that "the entire transaction took place in the state of

Washington and is controlled by Washington
w," and applied the rule of Lanzarotti.

The district court found from the evidence
produced in court and from the evidence set
forth in the stipulation of the parties, that
the signing of the note and mortgage at Newport,
Washington, was a mere matter of convenience.
On the issue of knowledge and lack of good
faith on the part of the corporations the court
stated that the corporations took the precaution
of entering computations on its own books at
Washington's legal rate of 8%, but for a period of
almost four years failed to advise the appellees
that they were being charged anything less than
the 10% interest exacted of them on the note
and mortgage.

The first written contract for the sale of
the prefabricated house, Defendant's Exhibit
No. 4, was signed on July 6, 1960, some 12

ys before the appellees signed the note and mortgage.

During this 12 day period of time, the contract, Defendants' Exhibit No. 4, calling for 120 monthly payments of \$68.01 which is just under 9% per annum, ripened into the note and mortgage calling for the payments of \$71.37, at 10% per annum. (\$5400.00 at 8½% on ten years requires payments of \$66.96; \$5400.00 at 9% on ten years requires payment of \$68.41)

The contract, Defendants' Exhibit No. 4, is a printed form of the Montana corporation. The note and mortgage are also on its printed forms, the mortgage specifically providing:

"This mortgage is executed with the mutual understanding that the prefabricated house or building purchased from Hughes Homes, Inc., under the contract dated July 6, 1960, shall be erected * * * *."

Defendants' Exhibit No. 2

The U. S. District Judge in applying the law to the facts of the case, stated that the most recent case involving the Lanzarotti rule came from the Ninth Circuit Court of Appeals, Whitman v. Greene, 1961, 289 Fed 2d 566, and the gist of the appeal is appellants' contention that the Lanzarotti rule was incorrectly applied, and that the District Judge's findings are improper and unsubstantiated.

In the Whitman case, the Circuit Court concluded by stating, as applied to that case:

"Under these circumstances we feel that the Lanzarotti rule must be read to apply to those cases involving the doing of business within the state of Idaho, and a purpose to evade the usury laws of that state. In the case at bar the lender did not seek out the borrower in the state of Idaho, nor sit in wait for him in that state. Rather, the borrower sought out the lender in the State of Washington."

The Lanzarotti rule was spelled out in the opinion, quoting directly from United States

Building and Loan Association v. Lanza, 29, 47 Idaho 287, 274 P. 630-632:

29, 47 Idaho 287, 274 P. 630-632:

This court stands committed to the rule that "this being purely an action in rem, and the enforcement of the claim being only maintainable in Idaho," it cannot be contended that the intention of the parties was that the laws of "Montana" should obtain in the construction of the contract. (citing Vermont Loan and Savings Association v. Shea)"

The Circuit Court analyzed Zimmerman v. Brown, 1917, 30 Idaho 640, 166 P. 924, in

reaching the conclusion of the Whitman case, and noted from Zimmerman the lack of "proof of bad faith or of an effort to evade the usury laws of this state," noting therefrom that it was not the in rem aspect which was the true basis of the Lanza rule.

The United States District Judge in the case at bar applied the rule as so defined, finding that the Montana corporation, qualified to do, and doing business in Idaho, took a note and mortgage usurious by Idaho

statute, and that payments were taken and received by both corporations.

As to the proof of bad faith, or of usurious intent, requisite proof of which as an essential was suggested in Whitman, the District Judge found a purpose to evade the usury law of Idaho, and noted the failure of the appellant corporations to advise appellees that they were being charged any less than the % per annum stipulated for in the note.

Appellants' Concessions

Appellants seem to concede that the Montana corporation is chargeable with the preparation of the note and mortgage, Appellants' Brief, 30 -- which concession is justified by the fact that the same were drawn on printed forms setting forth the corporate name, and appellee Edgar testified that the notary only acted in a notarial capacity.

the top of page 32, Appellant's Brief, is stated the concession that the Montana corporation is charged with knowledge that the maximum legal rate of interest in Idaho is 8%.

On the top of page 37, Appellant's Brief, is stated the distinction between the position of the Idaho acceptance corporation, here an signee of the non-negotiable mortgage, together with the debt thereby secured, and an endorsee in due course of negotiable paper without actual notice of usury.

In the next to last paragraph of page 37, Appellants' Brief is correctly stated that the Idaho usury statute "also makes provision for penalty to be suffered by the person to whomurious interest has been paid."

Finally, on page 38 of Appellants' brief is stated:

"As appellant has urged, the Lanza case is one wherein it was virtually held as a matter of law that a foreign corporation cannot loan money in Idaho, and reserve and collect interest in excess of the statutory maximum."

Contentions of Appellants

Examination of the facts and circumstances of the case, and a reading of the brief of appellants, including the foregoing concessions of the appellants, seems to indicate the gist of appellants position on appeal to be that stated on the bottom of page 38, Appellants' Brief, whereat the appellants say that the District Judge's determination that there was both a doing of business in Idaho and a purpose to evade Idaho law were erroneous conclusions of law, and not findings of fact at all.

Argument

Appellants cite to the Court the case of Lundgren v. Freeman, 1962, Ninth Circuit, 307 F.2d 104. In this case the Circuit Court resolved the question of whether or not the "clearly erroneous" provisions of Rule 52 (a) F.R. Civ. P. has application where it is contended on appeal that the credibility of the witnesses was not involved. The holding of the court was: "Rule 52 (a) explicitly clearly applies where the trial court has not had an opportunity to judge of the credibility of witnesses."

Lundgren v. Freeman, supra
At 114 of 307 F2d

It is submitted that the appellants go far afield in citing this case, for the reason that witnesses did testify in the case at bar, and it was for the District Judge to determine the credibility to be attached to the testimony of Mr. Edgar which established

at the transaction leading into the note and mortgage was an Idaho transaction. In any event, the "clearly erroneous" rule here applies, and it was the province of the trier of the facts to determine where the transaction took place, and to find as a fact the evasion of Idaho law, and of both faith on the part of the appellants.

"Rule 52(a) should be construed to encourage appeals that are based on a conviction that the trial court's decision has been unjust; it should not be construed to encourage appeals that are based on the hope that the appellate court will second-guess the trial court."

Lundgren v. Freeman, *supra*
at 114 of 307 Fed 2d.

This Edgar case, to be now decided by the Circuit Court is, as stated by the District Judge, "practically on four squares with the quoted factual situation in Lanzarotti." p. 53. Moreover, it is, from the

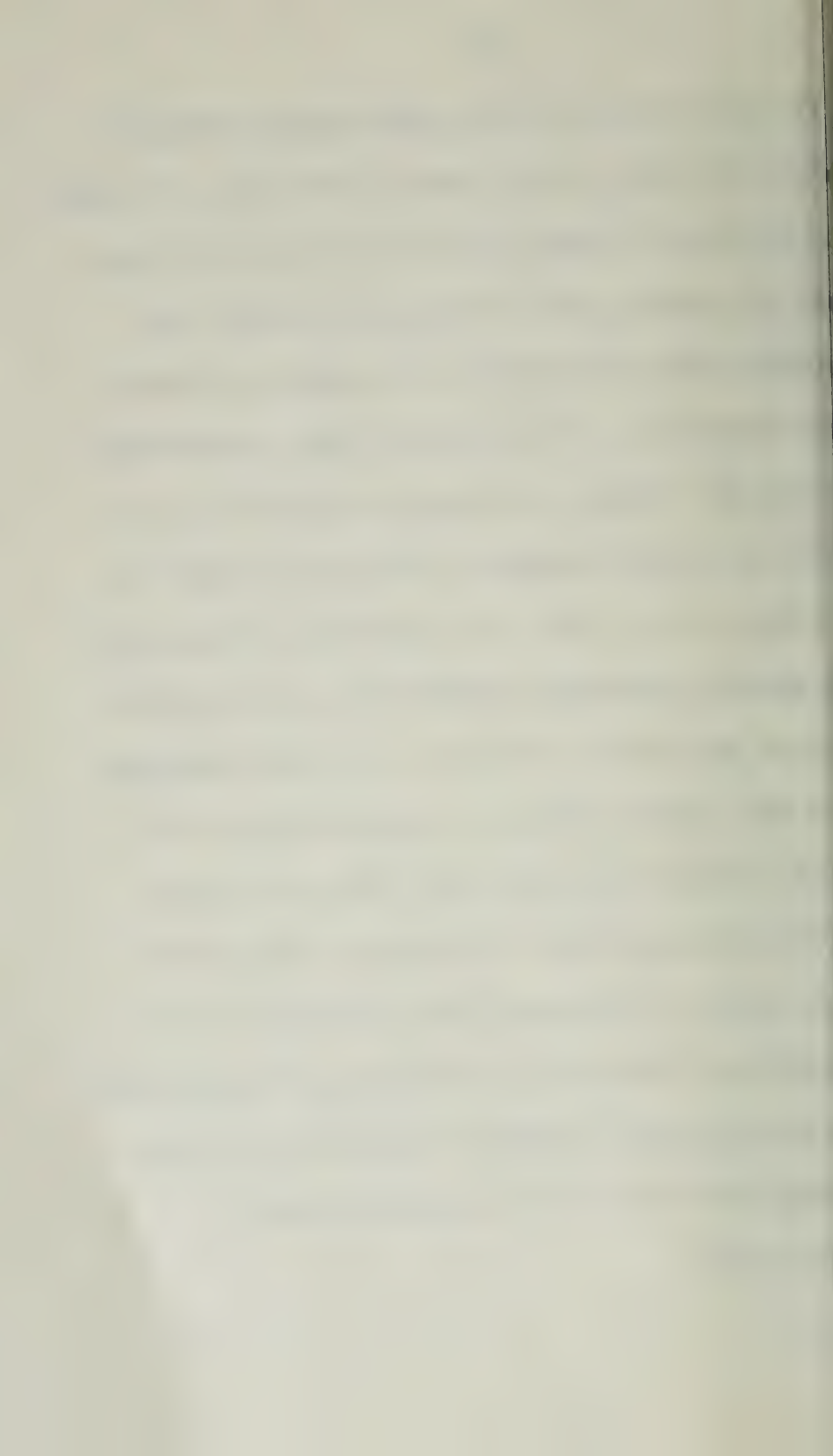
standpoint of an attorney or jurist
 having had "experience with the main-
 springs of human conduct" (Lundgren),
 case more deserving of judicial con-
 demnation and in stronger language than
 as used in Vermont Loan and Trust Co.

Hoffman, 1897, 5 Idaho 376, 49 P. 314,
 5 Am. St. Rep. 186, 37 L.R.A. 509, where
 the Idaho Supreme Court said, and the
 Ninth Circuit Court of Appeals quoted
 herefrom:

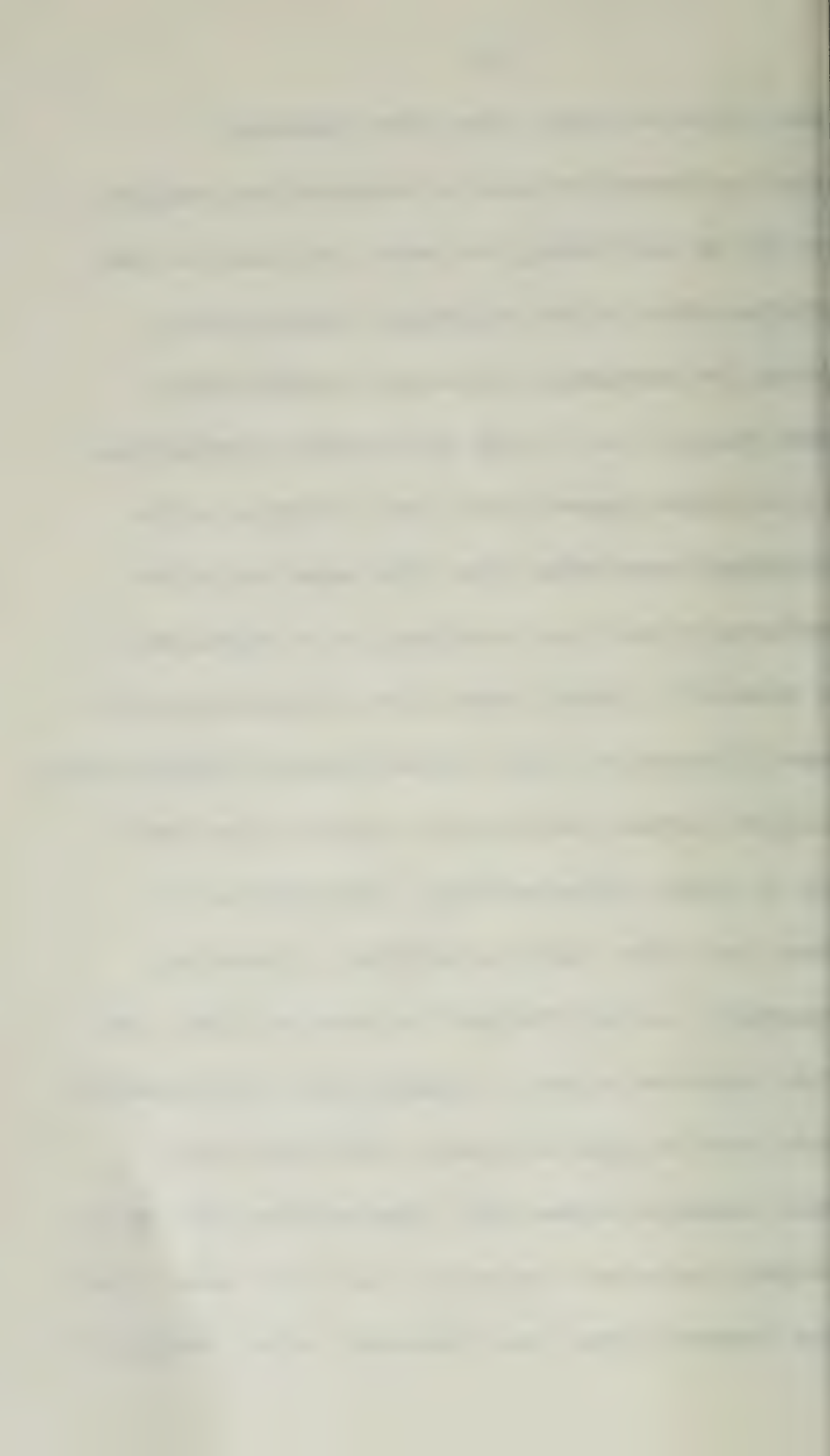
"The proposition simply states this:
 A foreign corporation, having a resi-
 dent agent in this state, engaged in
 the business of loaning money upon
 interest, may avoid the laws of this
 state in regard to such business, and
 especially in regard to usury, by
 simply making the evidences of indebted-
 ness payable in some other state, where
 the laws against usury are less onerous.
The monstrosity of the proposition is
too apparent to require comment. * * *"

Vermont Loan v. Hoffman,
 supra
 Whitman v. Green, Supra
 (emphasis added)

We have here an Idaho corporation owing its very existence to the laws of the state of Idaho, and which was formed specifically for the purpose of buying from the parent Montana corporation which borrowed it, mortgages on Idaho real property. We have this Idaho corporation buying and owning a mortgage on the real property of Idaho citizens, with the interest on the face set at 10%, and receiving and accepting monthly payments computed at that usurious rate of interest. We have, to borrow language from the Vermont case, the monstrosity of an Idaho corporation acquiring, from its parent Montana corporation, a ten-year, 120-payment note, with 119 payments yet to be made, the transaction supposedly purified by the mortgage, and note secured thereby, momentarily passing through the hands of the foreign parent corporation.



But, then we have, too, the foreign parent corporation also a corporation authorized to do and doing business in Idaho in competition with other building corporations, making the mortgage and note, encumbering Idaho realty, at a rate of interest prohibited to its Idaho competitors, and doing so with forehand knowledge that the same would be immediately sold and assigned at a discount to its domestic, Idaho subsidiary corporation, in competition with other Idaho finance corporations. Called before the bars of justice, we have both of these corporations, the Montana parent, and the Idaho subsidiary, pleading innocence, and on the boot-straps of their own office records alone, claiming that the penalty could not be applied where their own corporate records showed the transaction was being recorded the same status of its fifty some other Idaho transactions, and interest being computed



8% rather than the 10% stipulated for the note and mortgage.

Yet, caught on the horns of a dilemma, while urging that usury was not exacted on the corporate records because it was treated as Idaho transaction, the appellants continued to argue before the Circuit Court of Appeals that this was not an Idaho transaction at all. And, at the same time, because it is the truth, the appellants have admitted that from the time of signing the note and mortgage on their Idaho realty, there was never a time that the appellees were ever advised of the good news that they were in actuality being charged only 8% interest.

Any court of law or equity would require of the appellants that they informed the appellees accordingly. But they did not, not the Montana corporation, not the Idaho corporation,

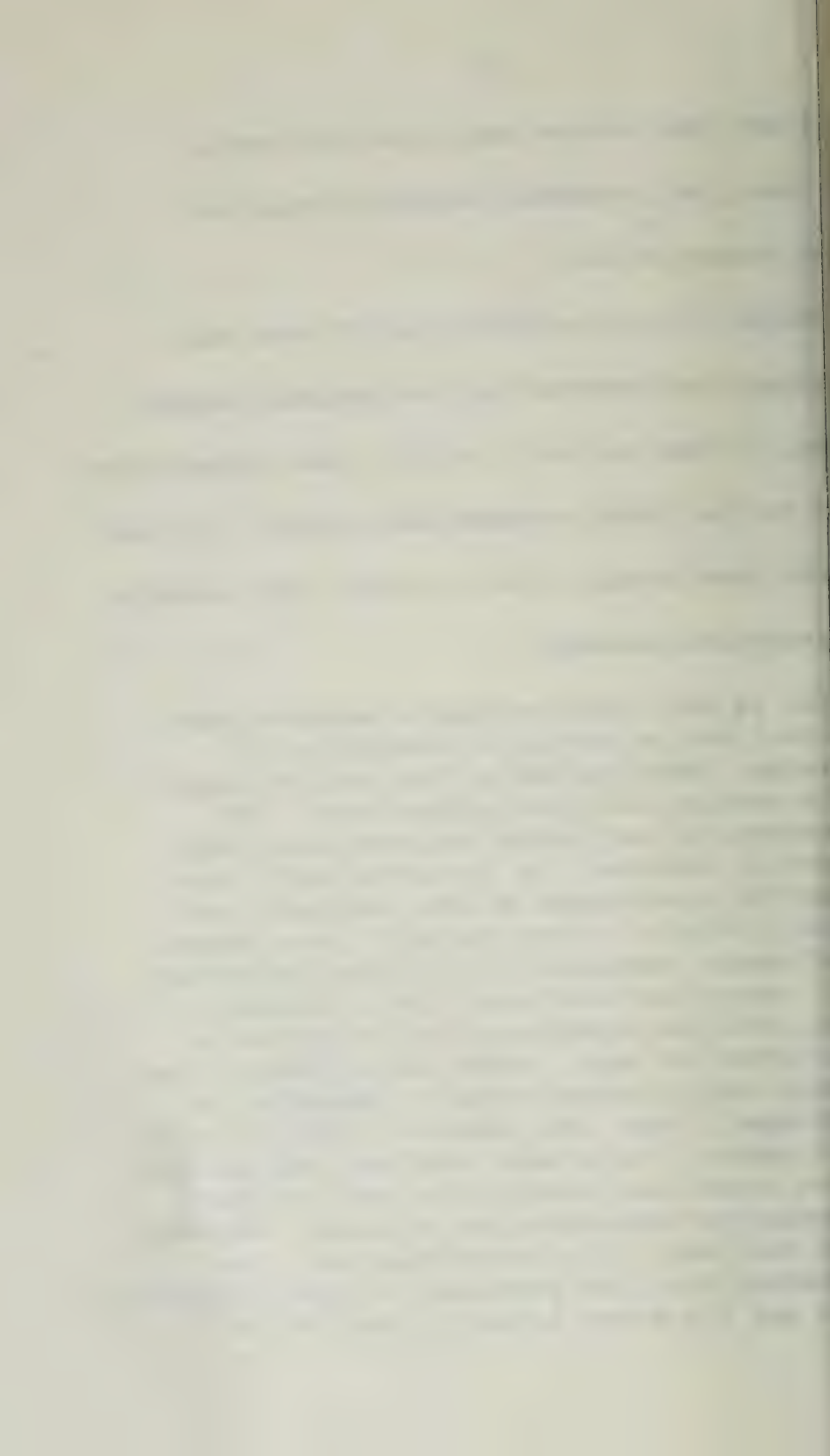


and not the trustee appointed for each.

In turn, all accepted payments based on the charge of 10%.

While it is true that the 10% rate was charged and reserved by the Montana corporation, it was not only paid to that corporation, but to the Idaho corporation as well. An old Idaho case seems to be in point, and contains appropriate comment:

"It is well settled, that a usurious contract may be purged of every taint of usury. (Webb on Usury, Sec. 482 et seq.) In section 482 that author says: 'Of course, if no usury has been paid, but merely reserved, it is sufficiently purged by a surrender of the contract, and the giving of a new one with the element of usury excluded.' It is also held that, if usury has been paid, the refunding of it, and its acceptance by the person in interest as such, under the agreement that only legal interest shall thereafter be charged, frees the contract from the taint of usury. It is well settled that parties can cancel and destroy the one contract, purge the consideration of usury, and make it the basis of a new obligation, and thereby bind the borrower, in law and equity, to pay the money actually received on



"and a legal rate of interest therefor. (Webb on Usury, Sec. 291, and authorities there cited.) That was done in this case. The intention of the appellant and respondents in making the renewal contract was to purge the old contract of usury, and destroy it and to make the new contract free and clear of all taint of usury; and they accomplished their intention. The offense of usury consists in taking unlawful interest, and in many states the penalty is quite severe, going to the forfeiture of the entire principal debt."

Sanford v. Kunz

9 Idaho 29, at page 34

71 Pac 612

As a matter of law, the, the appellants, and each of them, had the opportunity of purging the note and mortgage of usury by offering a new contract. This was not done, and the District Judge properly held:

"The defendant knew the interest to be improper, as evidenced by the fact that on the defendant's books the interest on each payment was charged at 8% (legal in Idaho). This certainly shows a knowledge by the defendant of a legal rate of interest in Idaho. Yet for a period of almost four years, the defendant and its

"assignee failed to advise the plaintiff that any lesser interest was being charged."

Tr. p. 54

ere clearly was the proof of effort to evade the usury laws of this state, and also proof of bad faith, both mentioned in the Zimmerman case, and quoted in Whitman.

Here was a case where appellants both in the trial court and now before the appellate court argue that the transaction was one of the state of Washington, and yet the mortgage was not assigned to the Washington subsidiary, but to the Idaho subsidiary.

Paraphrasing from the Lundgren case, page 115, and the first paragraph of the second column, the trial judge's findings of intent to evade Idaho law and of bad faith, and that the transaction was an Idaho transaction governed by the rule of Lanzarotti were not derived from application of legal standards, but from the trial judge's experience with human affairs.

"Therefore, we may not substitute our judgment if conflicting inferences may be drawn from the established facts by reasonable men, and the inferences drawn by the trial court are those which could have been drawn by reasonable men."

Lundgren v. Freeman, *supra*
at page 113, first column

It is submitted that the trial court, and now the appellate court, are being asked too much. Here appellants continually argue that appellees were charged only 8%, on the basis of Defendants' Exhibit No. 6. So long as the appellees were paying on a note that called for 120 payments of \$71.37 each, predicated upon a charge of 10% interest, and payments at that rate were paid to appellants, and received without any advice to the contrary being given appellees, the District Judge was correct in finding that both appellant corporations were paid and knowingly received interest at a rate usurious by Idaho law.

The first of these is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The second is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The third is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The fourth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The fifth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The sixth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The seventh is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The eighth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The ninth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

The tenth is the fact that the
government has been unable to
bring about a general agreement
with the various states and
territories on the subject of
the proposed constitution.

page 22 of appellants' brief, appellants
 ge that Lanzarotti can not be applied unless,
 appellants say the fact of the matter was
Lanzarotti, all of the elements of the
 ansaction are referable to one situs.
 To which it may be replied that in Lanzarotti
1 of the incidences of the transaction were
 t referable to one situs. In particular, the
 te was payable in Montana, the incident or
 ement of place of performance, and presum-
 ly in Cornelison v. United States Bldg. &
an Association, 1930, 50 Idaho 1, 150 P.
 55, the note was likewise payable in Mont-
 a. There is no justification for appellants
 argue at page 23, appellants' brief, that
 e case at bar is dissimilar from Lanzarotti,
rmont Loan, and Cornelison because of
 oreign subject matter and foreign contact."
 On evidence virtually without conflict or
 ntradiction, the District Judge found that

the Montana corporation was doing business in Idaho, and that it sought out the mortgagees in Idaho, sold them a prefabricated house in Idaho, and financed the same with a note and mortgage of Idaho realty, the mortgage being usurious on its face, with the mortgage to be immediately assigned to an Idaho subsidiary corporation. The "foreign contract" here is no different than it was in Lanzarotti -- the making of the obligation payable in Montana.

One other minor point should be mentioned. The mortgage purchased by the Idaho subsidiary, and assigned to it was not "negotiable paper" in the sense in which reference is made in sec. 27-1907 I.C. The mortgage was not endorsed to the Idaho corporation, but assigned, and, moreover, this is correct, because it could not be negotiable under the following provision therein contained:

"This mortgage is executed with the mutual understanding that the prefabricated house or building purchased from Hughes Homes, Inc., under the contract dated July 6, 1960, shall be erected * * * etc * *."

Mortgage, Defendants' Exhibit
No. 2

"An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. * * *"
 Sec. 27-105, I.C. Uniform Negotiable Instruments Law
 It is settled law that a bill or note, whether negotiable or non-negotiable, may be transferred from one person to another in various ways. It may be transferred by negotiation, either by delivery or by endorsement. Or, as was done here, whether negotiable or non-negotiable, "may be transferred by assignment. The Uniform Act does not prevent the transfer of a negotiable instrument by assignment. In fact it recognizes that a transferee is not always a holder in due course. It is clear, however, that an assignee takes generally only such title as his assignor subject to all defenses available



against his assignor." 8 Am Jur. 38-40, Bills
Notes.

The Idaho usury statute itself, 27-1907,
C., does not excuse even an indorsee of
negotiable paper, unless he does not have
actual notice of the usury.

In the case here under consideration, the
appellants have commendably at the bottom of
page 37, appellants' brief, acknowledged to
the court that the Idaho statute, in the
second sentence, specifically makes liable
the person "taking or receiving" usurious
interest, and it was exactly this provision
of the statute under which the District
Judge held the Idaho acceptance corporation
liable:

"In case the greater rate of interest
has been paid, the person by whom it
has been paid, or his legal representa-
tive, may recover back the amount of

"interest thus paid from the person taking or receiving the same, plus twice the amount of such interest in addition."

27-1907 I.C.

This was not only a non-negotiable mortgage, the mortgage carrying with it the note, and not the reverse, but it was assigned, and at the 10% rate, amounting to usury under Idaho law, showed on the face. The assignee not only is thus charged with knowledge of what the assignor did, but the assignee itself took and received all of the payments other than the first one.

The note in question calling for 10% interest is usurious on its face. And the following statement of the Idaho Supreme Court in the Arnelison case is appropriate here:

"* * the contract sought to be enforced is shown upon its face to be usurious.* *"

"Though the lender may not intend to be guilty of usury, yet he is nevertheless guilty for he intends to do what he does but mistakes the law."

"The contract was drafted by appellant or its agent, presented to and signed by respondents, and payments received thereunder. It would therefore hardly be consistent to hold upon the record before us that there was no violation of the provision of C.S. sec. 2554, in that appellant did not knowingly receive, reserve or charge a rate of interest greater than that allowed under the provisions of said section."

"There is ample evidence to support the court's finding 'that the defendants knowingly charged a rate of interest in excess of 10% per annum and that the contract is a usurious contract under the statutes of the state of Idaho."

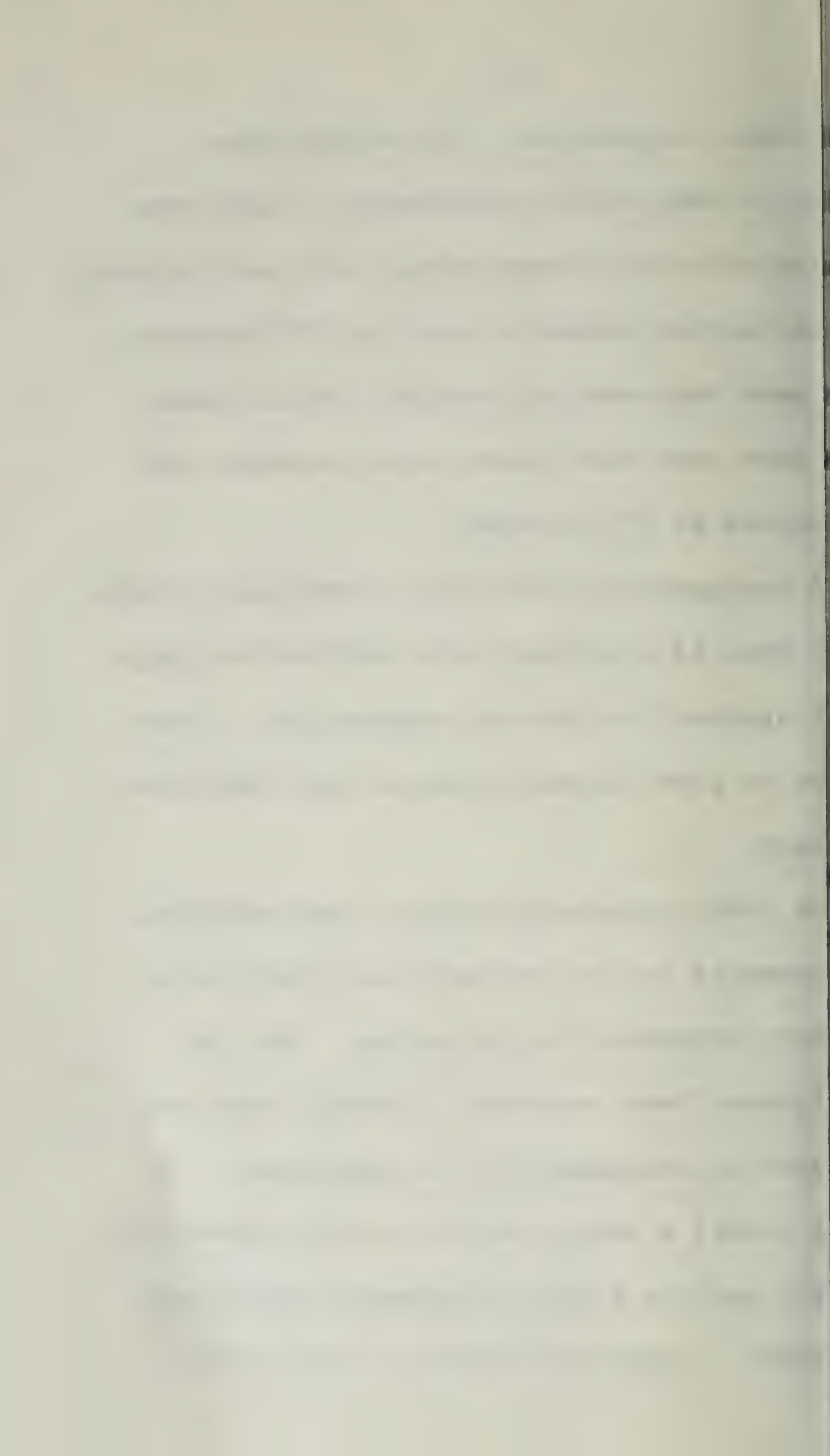
Cornelison v. U.S. Bldg.
Assn. 1930, 50 Idaho 1,
292 Pac. 243

The Idaho corporation was owned by the Montana corporation. Both were doing business in Idaho, one in the state of its creation, and the other by properly qualifying. Each had the same president. The Anaconda case clearly shows that the Montana corporation made its sales in Idaho, including this one to the appellees, and the immediate assignment of the mortgage to

the Idaho corporation. All of this was known to both of the corporation. And, then, on top of such circumstances, both participated in collecting payments based on 10% interest, and made book-keeping entries for use later, and here used four years later, showing computations at 10% interest.

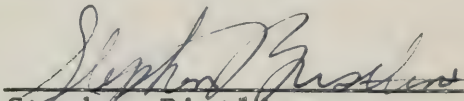
In Assignment of Error XIV, appellants claim that even if appellees were entitled to judgment against the Montana corporation, it was error to give judgment against the Idaho subsidiary.

The Idaho corporation on its own petition, presented by its trustee, had itself made party defendant to the action. Had its assignment been recorded, it would have been brought in originally by the appellees. It made itself a party, and the proof showed bad faith, and the taking of payments which wereurious. Appellants admit in the wording




the very Assignment XIV: "The statute so penalizes the person who is paid such interest rate." Appellants brief, p. 14. The District Judge made no error in giving judgment against both corporation. The Anzarotti case squarely applied.

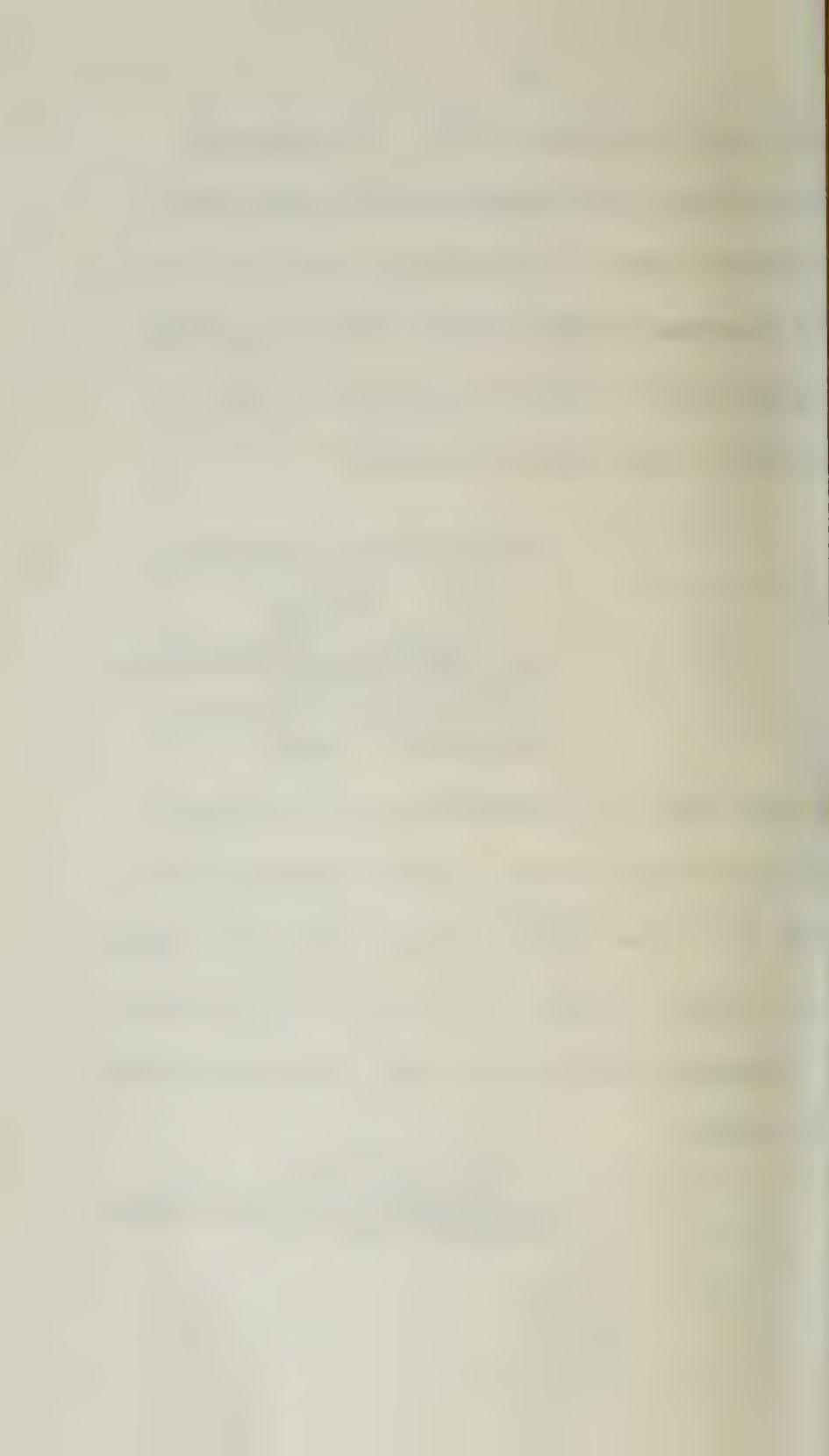
Respectfully submitted,



Stephen Bistline
Attorney for Appellees
Sandpoint, Idaho

certify that, in connection with the preparation of this brief, I have examined Rule 28 and 29 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.


Stephen Bistline



No. 20,480

IN THE
UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy
for HUGHES HOMES, INC., a Montana Corporation
and HUGHES HOMES ACCEPTANCE CORPORATION,
an Idaho Corporation,

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

Appellees.

APPELLANT'S PETITION FOR REHEARING

TO: The Honorable Circuit Judges, Barnes, Koelsch and Duniway
Constituting the Court in the original hearing in the
entitled cause

MAURICE F. HENNESSEY,
ARNOLD T. BEEBE,
Attorneys for Appellant
FURCHNER, ANDERSON & BEEBE of Counsel



No. 20,480

IN THE
UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy
for HUGHES HOMES, INC., a Montana Corporation
and HUGHES HOMES ACCEPTANCE CORPORATION,
an Idaho Corporation,

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

Appellees.

APPELLANT'S PETITION FOR REHEARING

TO: The Honorable Circuit Judges, Barnes, Koelsch and Duniway
Constituting the Court in the original hearing in the
entitled cause

MAURICE F. HENNESSEY,
ARNOLD T. BEEBE,
Attorneys for Appellant
FURCHNER, ANDERSON & BEEBE of Counsel



IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOHN N. NEWLAND, Trustee in Bankruptcy for
HUGHES HOMES, INC., a Montana Corporation
and HUGHES HOMES ACCEPTANCE CORPORATION,
an Idaho Corporation,

Appellant,

vs.

WINCEL T. EDGAR and HELEN E. EDGAR,
Husband and Wife,

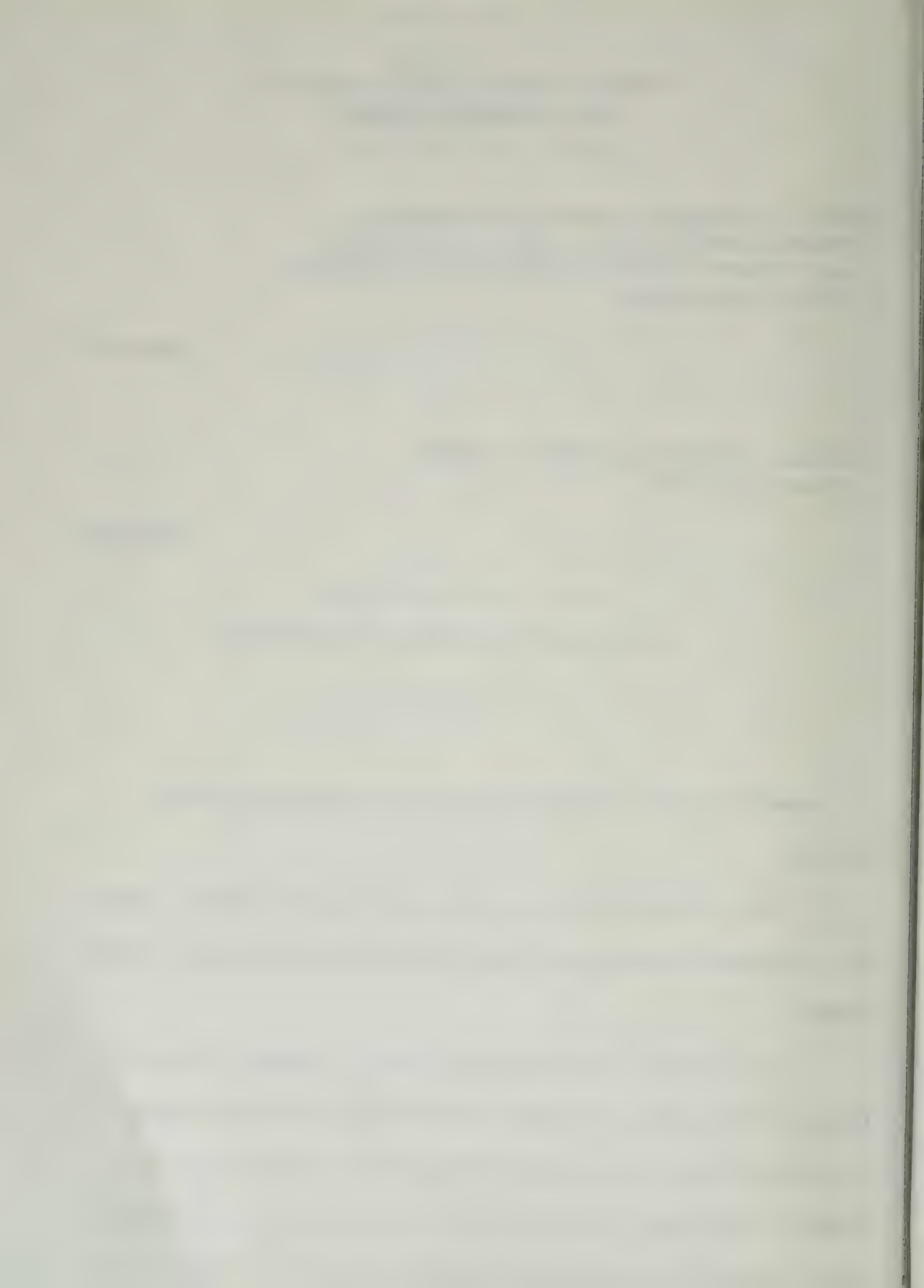
Appellees.

APPELLANT'S PETITION FOR REHEARING

Appellant hereby petitions for rehearing upon the following
grounds:

1. The decision of this appellate court was dated June 8, 1966,
and concluded that the district court lacked jurisdiction of the subject
matter.

2. The decision is premised upon John N. Newland, Trustee of
Hughes Homes, Inc., a Montana Corporation, and Hughes Homes
Acceptance Corporation, an Idaho Corporation, being an ordinary
trustee in bankruptcy, as distinguished from a trustee in proceedings
under Chapter X of the National Bankruptcy Act, Act of June 22, 1938, 52 Stat.



as amended 11 U.S.C. Sec. 501, et seq. (1958).

John N. Newland is such a Chapter X trustee (Anaconda Building Materials Co., et al., V. John N. Newland, Trustee of the Estate of Hughes Homes, Inc., et al., debtors, 9th Cir., 336 F2d 625; R. Tr. 14 in the case at bar).

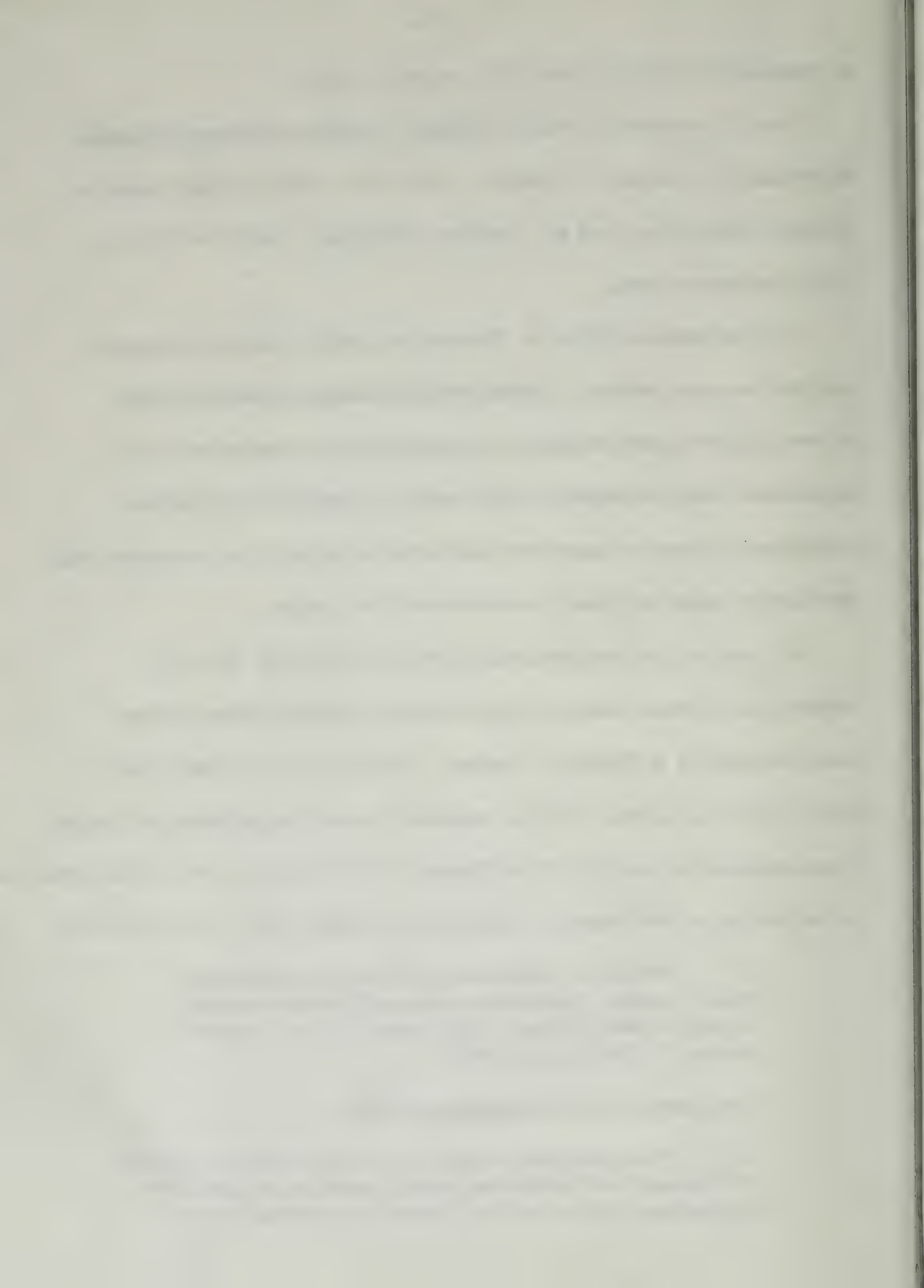
3. The status of John N. Newland as such a Chapter X trustee and the law upon which is based the jurisdiction of federal courts to hear plenary suits brought by a reorganization trustee were not emphasized and presented to this court on appeal by the parties. Accordingly, there is submitted authority for which it is contended that the district court did have jurisdiction of the cause.

4. Section 2 of the Bankruptcy Act (11 U.S.C.A. Sec. 11) confers jurisdiction upon all reorganization courts to hear plenary suits brought by a Chapter X trustee. Section 23 of the Bankruptcy Act (11 U.S.C.A. Sec. 46) was expressly made inapplicable to Chapter X proceedings by Section 102 of Chapter X (11 U.S.C.A. Sec. 502), and resu in the holding of Williams v. Austrian, 67 S.Ct. 1443; 331 U.S. 642:

" . . . With the limitations of Sec. 23 suspended, Sec. 2 confers jurisdiction upon all reorganization Courts to hear plenary suits brought by a Chapter X trustee." (331 U.S. at 661)

The Supreme Court in Austrian stated:

" . . . the conclusion more in accord with the purposes of Chapter X and with the pivotal position in which the trustee was placed is that Congress intended by the



elimination of Sec. 23 to establish the jurisdiction of the federal courts to hear plenary suits brought by a reorganization trustee, even though diversity or other usual ground for federal jurisdiction is lacking." (331 U.S. at 657-8)

The elimination of Sec. 23 allows the extensive jurisdiction conferred by Sec. 2a(6) and (7) to operate untrammelled. Independent grounds of federal jurisdiction, such as diversity of citizenship and amount in controversy are not required. (See 6 Collier on Bankruptcy, 14th Ed., Sec. 3.18 (pp. 663-664); Magidson v. Duggan, 180 F.2d 473 (C.A. 8, 1950)

Under the holding of Austrian, the federal district court in Idaho is a reorganization court having the jurisdiction conferred by Sec. 2 (331 U.S. at 658).

WHEREFORE, it is petitioned that rehearing be granted, the decision dated June 8, 1966, be withdrawn, and the questions raised on appeal be determined under the jurisdiction of this court.

Respectfully submitted,

MAURICE F. HENNESSEY
Butte, Montana

ARNOLD T. BEEBE
Blackfoot, Idaho

Attorneys for Appellant

FURCHNER, ANDERSON & BEEBE
Blackfoot, Idaho
Of Counsel

THE
JOURNAL OF THE
ROYAL ANTHROPOLOGICAL INSTITUTE

VOL. LXXV. PART I. 1945.

CONTENTS.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

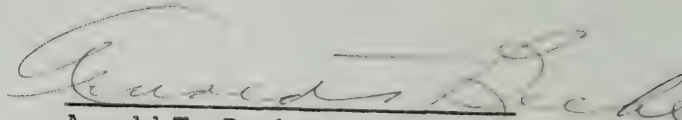
THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

THE ANTHROPOLOGY OF THE
MEDITERRANEAN REGION.

I certify that in my judgment the foregoing Petition for Rehearing is well founded, and further certify that is is not interposed for delay.

A handwritten signature in cursive script, appearing to read "Arnold T. Beebe", written over a horizontal line.

Arnold T. Beebe
Of Counsel for Appellant



NO. 20514

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHARLES MULRY, LEONARD POLONSKY,
IRVIN FISHMAN, LAWRENCE LEE,
CARMEN YUPPA and ROBERT BARRETT,

Appellants,

-vs-

WILLIAM DRIVER, Administrator of the
Veterans Administration, et al.,

Appellees.

Appeal from the United States District Court
For the Southern District of California,
Central Division.

APPELLANTS' OPENING BRIEF

ABRAHAM GORENFELD
1258 West First Street
Los Angeles, California 90026
MAdison 6-6272
Attorney for Appellants

FILED

FEB 11 1966

WM. B. LUCK, CLERK

TOPICAL INDEX

	Page
Statement of pleadings and facts disclosing jurisdiction.....	2
Statutes and regulations involved.....	5
38 U.S.C. 4104(1).....	5
38 U.S.C. 4108.....	5
38 U.S.C. 4114.....	5
38 U.S.C. 4115.....	6
5 U.S.C. 902.....	6
5 U.S.C. 911.....	7
5 U.S.C. 944.....	8
Sec. 204.06, VA Regulations.....	8
MP-5, Part II, Trans. No. 4, Sec. 3, VA Regulations.....	8
MP-5, Chap. 16-B, Chg. 3, Para. 2.04d, Page 2-4, VA Regulations.....	9
5 U.S.C.A. 1009.....	12
Concise statement of case.....	14
Specification of errors.....	16
Summary of argument.....	17
Argument.....	18
The District Court has jurisdiction, under the Administrative Procedure Act, to review action of the Veterans Administration challenged by appellants as being unreasonable and arbitrary and as depriving them, unconstitutionally, of their right to practice medicine, in violation of the First and Fifth Amendments to the United States Constitution.....	18
Conclusion.....	23

The following is a list of the names of the persons who have been elected to the office of Justice of the Peace for the year 1870.

- | Name | Residence |
|---------------------|-----------|
| John A. Smith | St. Louis |
| James B. Jones | St. Louis |
| William C. Brown | St. Louis |
| Charles D. White | St. Louis |
| Edward F. Green | St. Louis |
| George H. Black | St. Louis |
| Frederick I. Gray | St. Louis |
| Henry J. Hall | St. Louis |
| Isaac K. King | St. Louis |
| John L. Lee | St. Louis |
| Samuel M. Miller | St. Louis |
| Thomas N. Moore | St. Louis |
| William O. Parker | St. Louis |
| James P. Quinn | St. Louis |
| Robert R. Reed | St. Louis |
| David S. Russell | St. Louis |
| John T. Scott | St. Louis |
| Charles U. Stone | St. Louis |
| Edward V. Taylor | St. Louis |
| George W. Walker | St. Louis |
| Frederick X. Wright | St. Louis |
| Henry Y. Young | St. Louis |
| Isaac Z. Zimmerman | St. Louis |

The following is a list of the names of the persons who have been elected to the office of Justice of the Peace for the year 1870.

- | Name | Residence |
|---------------------|-----------|
| John A. Smith | St. Louis |
| James B. Jones | St. Louis |
| William C. Brown | St. Louis |
| Charles D. White | St. Louis |
| Edward F. Green | St. Louis |
| George H. Black | St. Louis |
| Frederick I. Gray | St. Louis |
| Henry J. Hall | St. Louis |
| Isaac K. King | St. Louis |
| John L. Lee | St. Louis |
| Samuel M. Miller | St. Louis |
| Thomas N. Moore | St. Louis |
| William O. Parker | St. Louis |
| James P. Quinn | St. Louis |
| Robert R. Reed | St. Louis |
| David S. Russell | St. Louis |
| John T. Scott | St. Louis |
| Charles U. Stone | St. Louis |
| Edward V. Taylor | St. Louis |
| George W. Walker | St. Louis |
| Frederick X. Wright | St. Louis |
| Henry Y. Young | St. Louis |
| Isaac Z. Zimmerman | St. Louis |

The following is a list of the names of the persons who have been elected to the office of Justice of the Peace for the year 1870.

TABLE OF AUTHORITIES CITED

Cases	Page
Adams v. Witmer, 271 Fed. 2d 29 (9th Cir. 1958).....	18, 19
Adler v. Board of Education, 342 U.S. 485.....	23
Air Line Pilots Ass'n, Int. v. Quesada, 182 Fed. Supp. 595 (U.S. D.C. SD, N.Y., 1960).....	22
Braude v. Wirtz, 350 Fed. 2d 702 (9th Cir. 1965).....	24
Estrada v. Ahrens, 296 Fed. 2d 690 (5th Cir. 1961).....	19, 20
Farmers v. Philadelphia Electric Co., 328 Fed. 2d 3 (3rd Cir. 1964).....	22
Ferry v. Udall, 336 F. 2d 609 (9th Cir. 1964).....	20, 21, 22
First National Bank of Smithfield, North Carolina v. Saxon, 352 Fed. 2d 267 (4th Cir. 1965).....	22
Friedman v. Schellenbach, 159 Fed. 2d 22.....	21
Indiviglio v. United States, 299 Fed. 2d 266.....	21
Shaughnessy v. Pedreiro, 349 U.S. 48, 75 S. Ct. 591, 99 L. Ed. 868 (1955).....	19
Williamson v. Holland, 232 Fed. Supp. 479 (U.S. D.C. E.D. N.C., 1963).....	22

THE HISTORY OF THE

1. The first part of the history is the history of the world from the beginning of time to the present day.
2. The second part of the history is the history of the world from the present day to the future.
3. The third part of the history is the history of the world from the future to the end of time.
4. The fourth part of the history is the history of the world from the end of time to the beginning of time.
5. The fifth part of the history is the history of the world from the beginning of time to the end of time.
6. The sixth part of the history is the history of the world from the end of time to the beginning of time.
7. The seventh part of the history is the history of the world from the beginning of time to the end of time.
8. The eighth part of the history is the history of the world from the end of time to the beginning of time.
9. The ninth part of the history is the history of the world from the beginning of time to the end of time.
10. The tenth part of the history is the history of the world from the end of time to the beginning of time.
11. The eleventh part of the history is the history of the world from the beginning of time to the end of time.
12. The twelfth part of the history is the history of the world from the end of time to the beginning of time.
13. The thirteenth part of the history is the history of the world from the beginning of time to the end of time.
14. The fourteenth part of the history is the history of the world from the end of time to the beginning of time.
15. The fifteenth part of the history is the history of the world from the beginning of time to the end of time.
16. The sixteenth part of the history is the history of the world from the end of time to the beginning of time.
17. The seventeenth part of the history is the history of the world from the beginning of time to the end of time.
18. The eighteenth part of the history is the history of the world from the end of time to the beginning of time.
19. The nineteenth part of the history is the history of the world from the beginning of time to the end of time.
20. The twentieth part of the history is the history of the world from the end of time to the beginning of time.

TABLE OF AUTHORITIES CITED

Statutes	Page
U. S. Constitution, Article III, Sec. 2.....	4
First Amendment.....	3, 18
Fifth Amendment.....	3, 18
Title 5 U.S.C. 902.....	6, 7
911.....	3, 7
944.....	3, 8
1001 <i>et seq.</i> *.....	4, 17, 18, 19, 24
1009.....	4, 12, 13, 14, 16, 17, 20

*Administrative Procedure Act

Title 28 U.S.C. 1291.....	4
1331.....	4
1346.....	4
Title 29 U.S.C. 2201.....	4
2202.....	4
Title 38 U.S.C. 211(a).....	22
4104(1).....	2, 5
4108.....	3, 5, 6, 22
4110.....	23
4114.....	5, 6
4115.....	6, 22

Regulations

Sec. 204.06 Veterans Administration Regulations.....	3, 8
MP-5, Part II, Trans No. 4, Section 3, Veterans Administration Regulations.....	8
MP-5, Chap. 16-B, Chg. 3, Para. 2.04d, Page 2-4, Veterans Administration Regulations.....	8, 9, 10, 11, 12

NO. 2 0 5 1 4

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHARLES MULRY, LEONARD POLONSKY, IRVIN
FISHMAN, LAWRENCE LEE, CARMEN YUPPA and
ROBERT BARRETT,

Appellants,

-VS-

WILLIAM DRIVER, Administrator of the
Veterans Administration, et al.,

Appellees.

Appeal from the United States District Court
For the Southern District of California,
Central Division.

APPELLANTS' OPENING BRIEF

TO THE HEAD JUDGE AND JUDGES OF THE ABOVE-
ENTITLED COURT:

THE UNIVERSITY OF CHICAGO

1964

DEPARTMENT OF CHEMISTRY

PHYSICAL CHEMISTRY

PROFESSOR OF CHEMISTRY
AND PHYSICS, UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS 60637

RECEIVED

1964

RECEIVED BY THE UNIVERSITY OF CHICAGO
LIBRARY, 100 EAST 57TH STREET, CHICAGO, ILL. 60637

RECEIVED

RECEIVED BY THE UNIVERSITY OF CHICAGO
LIBRARY, 100 EAST 57TH STREET, CHICAGO, ILL. 60637

RECEIVED

RECEIVED BY THE UNIVERSITY OF CHICAGO

LIBRARY

RECEIVED BY THE UNIVERSITY OF CHICAGO

LIBRARY

STATEMENT OF PLEADINGS AND
FACTS DISCLOSING BASIS OF JURISDICTION

Appellants are resident physicians employed at the Long Beach Veterans Hospital in Long Beach, California. On behalf of themselves and other resident physicians employed there, they filed a Complaint for Injunction and For Declaratory Relief in the United States District Court, Southern District of California, Central Division, against William Driver, Administrator of the Veterans Administration; Joseph H. McNinch, Chief Medical Director, Department of Medicine and Surgery, Veterans Administration; Joseph Glotfelty, Staff Assistant to Chief Medical Director; and M. L. Matte, Hospital Director of the Long Beach Veterans Hospital (T.¹/pp. 2 - 22).

Appellants sought judicial review of an order and regulation made by the Administrator of the Veterans Administration, William Driver, and threatened enforcement thereof by the other appellees, declaring that resident physicians appointed under authority of Title 38 U.S.C. 4104(1) are employed on a full-time basis for 24 hours a day, 7 days a week, and are, therefore, prohibited from engaging in extra-Veterans Administration professional activities for remuneration (T. p. 3, ll. 12 - 23).

Appellants challenged the constitutionality of said regula-

[1] All references are to the Clerk's Transcript.

tion, issued by William Driver, Administrator, under authority of Title 38 U.S.C. 4108, contending that the same violated the Fifth Amendment to the United States Constitution by depriving them of liberty and property (the right to work at other places on their off-duty hours), without due process of law (T. p. 7, 11. 25 - 32); by taking private property for public use, without just compensation (T. p. 8, 11. 14 - 17); by denying them equal protection of the laws by imposing unreasonable and arbitrary restrictions upon appellants in their practice of medicine (T. p. 8, 11. 18 - 26); by denying them the benefits of the basic administrative workweek of forty (40) hours (Title 5 U.S.C. 944) and overtime compensation (Title 5 U.S.C. 911) which is applicable to other federal employers (T. p. 8, 1. 30 to p. 9, 1. 5).

Appellants further challenged the attempt of said William Driver, by threatened enforcement of Veterans Administration Regulation, Section 204.06, to prohibit them from discussing an investigation being conducted by the Veterans Administration into alleged violations by resident physicians of regulation prohibiting outside professional activity. Appellants contended this was in violation of their rights of freedom of speech and of the press and to petition the government for redress of grievances as guaranteed by the First Amendment to the United States Constitution (T. p. 9, 11. 9 - 13).

Jurisdiction of the United States District Court was invoked under Article III, Section 2, of the United States Constitution, under 28 U.S.C. 1331 and 1346 (T. p. 2, 11. 30 - 32) and 5 U.S.C. 1001 *et seq.*

Declaratory relief was sought pursuant to the provisions of 5 U.S.C. Section 1009(b) and 29 U.S.C. Section 2201. Interlocutory relief was sought under the provisions of 5 U.S.C. Section 1009(d) and 28 U.S.C. Section 2202 (T. p. 3, 11. 19 - 23).

Appellees moved to dismiss the action, on the grounds that the court lacked jurisdiction over the subject matter and that the complaint failed to state a claim upon which relief could be granted (T. p. 38), contending that this was an action against the United States of America, which had not consented to the suit, and that the complaint did not present a substantial constitutional question (T. pp. 39 - 42).

The Motion to Dismiss was granted on the grounds that the action, in effect, was one brought against the United States without its consent and that the court lacked jurisdiction thereof (T. p. 40).

This Court has jurisdiction to review the Order of Dismissal under 28 U.S.C. Section 1291.

THE UNIVERSITY OF CHICAGO

DEPARTMENT OF CHEMISTRY

PHYSICAL CHEMISTRY

PH.D. THESIS

THEORY OF THE

STRUCTURE OF

THE

CRYSTAL

OF

THE

CRYSTAL

OF

THE

CRYSTAL

OF

THE

CRYSTAL

OF

THE

CRYSTAL

OF

THE

STATUTES AND REGULATIONS INVOLVED

38 U.S.C. 4104(1)

"There shall be appointed by the Administrator additional personnel as he may find necessary for the medical care of veterans, as follows:

"(1) Physicians, dentists, and nurses; . . ."

38 U.S.C. 4108

"Notwithstanding any law, Executive order, or regulation, the Administrator shall prescribe by regulation the hours and conditions of employment and leaves of absence of physicians, dentists, and nurses."

38 U.S.C. 4114

"(a) (1) The Administrator, upon recommendation of the Chief Medical Director, may employ, without regard to civil service or classification laws, rules, or regulations -

(A) physicians, dentists, nurses, dietitians, social workers, librarians, and other professional, clerical, technical, and unskilled personnel (including interns, residents, trainees, and students in medical support programs) on a temporary full-time or part-time basis; and

(B) physicians, dentists, nurses, and other professional and technical personnel on a fee basis.

(2) Personnel employed under paragraph (1) of this subsection shall be

in addition to personnel described in section 4103, paragraph (1) of section 4104, and section 4111 of this title and shall be paid such rates of pay as the Administrator may prescribe.

(3) (A) Temporary full-time appointments of physicians, dentists, and nurses may exceed ninety days only if the Chief Medical Director finds that circumstances render it impracticable to obtain the necessary services through appointments under paragraph (1) of section 4104 of this title. Temporary full-time appointments of other personnel shall not exceed ninety days.

(B) No part-time appointment shall be for a period of more than one year, except for appointments of physicians, dentists, nurses and interns, and residents and other trainees in medical support programs."

38 U.S.C. 4115

"The Chief Medical Director with the approval of the Administrator, unless specifically otherwise provided, shall promulgate all regulations necessary to the administration of the Department of Medicine and Surgery and consistent with existing law, including regulations relating to travel, transportation of household goods and effects, and deductions from pay for quarters and subsistence; and to the custody, use, and preservation of the records, papers, and property of the Department of Medicine and Surgery."

5 U.S.C. 902

"(a) Sections 84, 663, 667, 672(a), 673 of this title, and this chapter shall

not apply to (1) elected officials; (2) Federal judges; (3) heads of departments or of independent establishments or agencies of the Federal Government, including Government-owned or controlled corporations; (4) employees of the District of Columbia municipal government whose compensation is fixed by the Teachers' Salary Act of June 4, 1924, as amended; (5) officers and members of the Metropolitan Police or of the Fire Department of the District of Columbia; and (6) student nurses, medical or dental interns, residents-in-training, student dietitians, student physical therapists, and student occupational therapists, assigned or attached to a hospital, clinic, or medical or dental laboratory operated by any department, agency, or instrumentality of the Federal Government, or by the District of Columbia, and any other student-employees, assigned or attached to any such hospital, clinic, or laboratory primarily for training purposes, who may be designated by the head of such department, agency, or instrumentality, or by the Commissioner of the District of Columbia, as the case may be, with the approval of the Civil Service Commission. As used in this subsection the term 'elected officials' shall not include officers elected by the Senate or House of Representatives who are not members of either body. . . . "

SUBCHAPTER II. COMPENSATION FOR OVERTIME

5 U.S.C. 911

"Officers and employees to whom this subchapter applies shall, in addition to their basic compensation, be compensated for all hours of employment, officially ordered or approved, in excess of forty hours in any administrative workweek, at overtime rates as follows: . . . "

"Establishment of basic workweek; pay period; pay computation methods; application by Architect of the Capitol and Librarian of Congress.

"It shall be the duty of the heads of the several departments and independent establishments and agencies in the executive branch, including Government-owned or controlled corporations, and the District of Columbia municipal government, to establish as of July 1, 1945, for all full-time officers and employees in their respective organizations, in the departmental and the field services, a basic administrative workweek of forty hours, and to require that the hours of work in such workweek be performed within a period of not more than six of any consecutive days. . . . "

Section 204.06,
Veterans Administration Regulations

"All testimony given during an investigation conducted by the Investigation Service is for the use of the Administrator and his staff, except as provided in paragraphs 205.02f and 205.04 and will not be disclosed to unauthorized persons within or without the Veterans Administration. All employees will refrain from discussing matters under investigation during the investigation or after its completion."

MP-5, Part II, Trans. No. 4, Section 3,
Veterans Administration Regulations

"c. Outside Professional Activities of Full-Time Employees. Full-time physicians, dentists, nurses, residents and interns will be prohibited from engaging in extra-Veterans Administration professional activities for remuneration. . . ."

"Outside Professional Activities of Full-Time Physicials, Dentists, Nurses, Residents and Interns. Physicians, dentists and nurses appointed under the authority of Title 38 U.S.C. 4104(1) are employed on a full-time basis for 24 hours a day, 7 days per week. Such personnel are, therefore, prohibited from engaging in extra-VA professional activities for remuneration. This prohibition equally applies to residents and interns appointed under the authority of Title 38 U.S.C. 4114(b). Defined below are certain specific terms and conditions relating to extra VA professional activities which are prohibited or may be permitted in keeping with the above requirement.

"1. Prohibited Activities

(a) Private practice.

1. Office practice.
2. Consultation practice with remuneration.
3. Other conventional medical practice.

(b) Private practice equivalents for purpose of Department of Medicine and Surgery employment.

1. Accepting financial remuneration, directly or indirectly, for rendering a professional, scientific, technical or administrative service related to their profession, including teaching, from:

a. Another physician, dentist or from any hospital or clinic, including those associated with the VA through

a Deans Committee relationship or otherwise;

b. A commercial concern, such as insurance company, surgical instrument, pharmaceutical or drug firm or manufacturer, dry goods store, hotel, etc.;

c. An industrial concern, such as a coal mine, chemical plant or industry, steel plant, etc.;

d. Teaching in a medical school or other educational institution, including one affiliated with the VA hospital in which the individual is employed and including not only teaching in undergraduate, graduate and postgraduate instruction or in the administration of such instruction, but also the instruction and administration of instruction in refresher courses, courses for technicians, etc.;

e. 'Running' or directing a laboratory or clinic such as:

(1) X-Ray laboratory or clinic

(2) Clinical pathology laboratory

(3) Bacteriology laboratory

(4) Pulmonary function laboratory

(5) Radioisotope laboratory

(6) Radioisotope
clinic, etc.,

or serving as a consultant to
such laboratories.

2. When not accepting finan-
cial remuneration, directly or
indirectly:

a. When (except as a
teacher) this practice serves
to take the place of a physi-
cian who would otherwise have
to perform the service rendered,
particularly in situations such
as are cited in subparagraph a,
b, c and e above.

b. When such action might
result in:

(1) Impairing the effi-
ciency of the VA employee
in his job;

(2) Being construed as
official acts of the VA
when it is done by an
individual in a private
capacity;

(3) Criticism of or
embarrassment to, the VA.

"2. Permitted Practices

(a) Acceptance of non-monetary awards

(b) Acceptance of a reimbursement for
actual expenses incurred in delivering lec-
tures, etc.

(c) Consultation. (An advisory pro-
fessional opinion in isolated instances
involving a single patient without remun-
eration or responsibility for medical care).

(d) Performing emergency services without remuneration to those involved in an accident or other bona fide emergency."

5 U.S.C.A. 1009

"Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion.

"(a) Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

"(b) The form of proceeding for judicial review shall be any special statutory review proceeding relevant to the subject matter in any court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action (including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus) in any court of competent jurisdiction. Agency action shall be subject to judicial review in civil or criminal proceedings for judicial enforcement except to the extent that prior, adequate, and exclusive opportunity for such review is provided by law.

"(c) Every agency action made reviewable by statute and every final agency action for which there is no other adequate remedy in any court shall be subject to judicial review. Any preliminary, procedural, or intermediate agency action or ruling not directly reviewable shall be subject to review upon the review of the final agency action. Except as otherwise expressly required by statute, agency action otherwise final shall be final for the purposes of this subsection whether or not there has been presented or determined any application for a declaratory order, for any form of reconsideration, or (unless the

unpublished manuscript, 1911
written under the pseudonym
"John Galt" and dated as written on it
"1911"

MS. A. 9.2.1.1.1

Manuscript written by J. G. Galt, 1911
in the handwriting of the author
concerning the life of the author

This manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt"

The manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt". The manuscript
contains all the information that
the author has gathered up to the
date of the writing of the
manuscript and is written under
the pseudonym of "John Galt".
The manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt". The manuscript
contains all the information that
the author has gathered up to the
date of the writing of the
manuscript and is written under
the pseudonym of "John Galt".

The manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt". The manuscript
contains all the information that
the author has gathered up to the
date of the writing of the
manuscript and is written under
the pseudonym of "John Galt".
The manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt". The manuscript
contains all the information that
the author has gathered up to the
date of the writing of the
manuscript and is written under
the pseudonym of "John Galt".
The manuscript contains all the
information that the author has
gathered up to the date of the
writing of the manuscript and is
written under the pseudonym of
"John Galt". The manuscript
contains all the information that
the author has gathered up to the
date of the writing of the
manuscript and is written under
the pseudonym of "John Galt".

agency otherwise requires by rule and provides that the action meanwhile shall be inoperative) for an appeal to superior agency authority.

"(d) Pending judicial review any agency is authorized, where it finds that justice so requires, to postpone the effective date of any action taken by it. Upon such conditions as may be required and to the extent necessary to prevent irreparable injury, every reviewing court (including every court to which a case may be taken on appeal from or upon application for certiorari or other writ to a reviewing court) is authorized to issue all necessary and appropriate process to postpone the effective date of any agency action or to preserve status or rights pending conclusion of the review proceedings.

"(e) So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 1006 and 1007 of this title or otherwise reviewed on the record of an agency hearing provided by statute; (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In

making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.
... "

CONCISE STATEMENT OF CASE

Contending that the salaries paid to them were insufficient to enable them to maintain minimum standards of health, decency and comfort for their families, appellants alleged that many of them are compelled to, and do, engage in "moonlighting" to supplement their salaries. They further contend that hospitals and clinics in the Long Beach area are urgently in need of their services, in order to provide adequate medical care to people living in that area. (T. p. 6, 11. 13 - 32.)

However, by reason of Veterans Administration Regulations promulgated by appellee William Driver, as Administrator of the Veterans Administration, and appellee Joseph H. McNinch, Chief Medical Director of the Veterans Administration, Department of Medicine and Surgery, and threatened enforcement thereof by appellees, appellants were being required to cease and desist from outside professional activities, were being threatened with disciplinary action if they continued, were being investigated to determine whether they had violated said

regulations, and were threatened with disciplinary action if they discussed said investigation.

Appellants challenged the constitutionality of appellees' action and threatened action, sought injunctive and declaratory relief, and requested the convening of a Three-Judge Court (T. pp. 2 - 12).

In response, appellees filed a Motion to Dismiss, which was granted by the trial court on the ground that the action, in effect, was one brought against the United States without its consent and that the court lacked jurisdiction thereof. The trial court's order granting Motion to Dismiss was entered on October 14, 1965 (T. p. 40). Appellants filed Notice of Appeal to this Court on October 19, 1965 (T. p. 53).

On this appeal, the questions involved are:

(1) Is this action one brought against the United States of America or is it one brought against agents and officers of the federal government, challenging their actions, which are alleged to be unconstitutional, invalid, and void exercise of powers vested in them?

(2) If this is an action against the United

States of America, has it consented thereto by virtue of 5 U.S.C.A. 1009?

(3) Does the United States District Court have jurisdiction of this action?

SPECIFICATION OF ERRORS

The trial court erred in holding and entering its order dismissing this action, because:

(1) This is not an action against the United States of America but against officers of the federal government alleged to be acting in excess of the constitutional and valid powers conferred upon them;

(2) The United States of America has consented to this action (5 U.S.C. 1009); and

(3) The United States District Court has jurisdiction of this action.

SUMMARY OF ARGUMENT

By virtue of the Administrative Procedure Act, 5 U.S.C.A. section 1001 *et seq.*, the United States of America has waived its sovereign immunity with respect to this action.

The Veterans Administration is an "agency" within the meaning of said Act, and its rules and regulations herein challenged, and the sanctions threatened for violation thereof, involve an "agency proceeding" within the scope of the Act (5 U.S.C.A. section 1001 (a), (c), (f), and (g).)

Appellants are persons suffering legal wrong because of action of said agency, are adversely affected and aggrieved by such action, and are entitled to judicial review as provided in 5 U.S.C.A. 1009.

No statute precludes judicial review nor is the action of this agency, by law, committed to agency discretion. No Congressional intent appears to preclude judicial review of rules and regulations of the Veterans Administrator which unreasonably and arbitrarily deny appellants the right to practice their profession, as doctors, during their off-duty hours.

AMERICAN MEDICAL ASSOCIATION
PUBLISHED WEEKLY
CHICAGO, ILL., U.S.A.

Subscription prices: Five dollars per annum in advance. Single copies, fifteen cents.
Entered as second-class matter, May 2, 1912, under post office number 384, at Chicago, Ill., under special agreement of post office and post paid.
Acceptance for mailing at special rate of postage provided for in Act of October 3, 1917, authorized on July 1, 1918.

Copyright, 1918, by American Medical Association
Published by the American Medical Association, 535 North Dearborn Street, Chicago, Ill.
Second-class postage paid at Chicago, Ill., and at additional mailing offices.
Postmaster: Send address changes in this journal to THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION, 535 North Dearborn Street, Chicago, Ill.

Subscription orders, notices of change of address, and other correspondence should be sent to THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION, 535 North Dearborn Street, Chicago, Ill.
Entered as second-class matter, May 2, 1912, under post office number 384, at Chicago, Ill., under special agreement of post office and post paid.
Acceptance for mailing at special rate of postage provided for in Act of October 3, 1917, authorized on July 1, 1918.
Copyright, 1918, by American Medical Association
Published by the American Medical Association, 535 North Dearborn Street, Chicago, Ill.
Second-class postage paid at Chicago, Ill., and at additional mailing offices.
Postmaster: Send address changes in this journal to THE JOURNAL OF THE AMERICAN MEDICAL ASSOCIATION, 535 North Dearborn Street, Chicago, Ill.

ARGUMENT

THE DISTRICT COURT HAS JURISDICTION,
UNDER THE ADMINISTRATIVE PROCE-
DURE ACT, TO REVIEW ACTION OF THE
VETERANS ADMINISTRATION CHALLENGED
BY APPELLANTS AS BEING UNREASONABLE
AND ARBITRARY AND AS DEPRIVING THEM,
UNCONSTITUTIONALLY, OF THEIR RIGHT
TO PRACTICE MEDICINE, IN VIOLATION
OF THE FIRST AND FIFTH AMENDMENTS
TO THE UNITED STATES CONSTITUTION.

With respect to the effect of the Administrative Procedure Act on the question of jurisdiction and right of judicial review of administrative action, the leading case in this circuit appears to be *Adams v. Witmer*, 271 Fed. 2d 29 (9th Cir. 1958). In that case, as here, the lower court dismissed, for lack of jurisdiction, an action against an administrative officer, since "the action, in effect, is an action against the government of the United States, and the government has not consented to be sued." (p. 32) This Court reversed, holding that the Administrative Procedure Act is applicable, and provided a right of judicial review. In so holding, this Court declared:

"This express authorization of judicial review in this case disposes of the argument that the suit is in substance one against the United States where the United States has not given its consent to be sued. The United States has consented to this review. The fact that the United States has

some interest in the controversy does not provide an exception to the grant of a right to review."

Adams v. Witmer, 271 Fed. 2d.
29, 34.

Affirmation and development of this view resulted in *Estrada v. Ahrens*, 296 Fed. 2d 690 (5th Cir. 1961). In that case, appellants sought judicial review under 5 U.S.C.A. 1001 *et seq.* of an order of the Immigration and Naturalization Service excluding them from the country. Injunctive relief against the District Director was also prayed for. The District Court dismissed for lack of jurisdiction. On appeal, the court noted that in *Shaughnessy v. Pedreiro*, 349 U.S. 48, 75 S. Ct. 591, 99 L. Ed. 868 (1955), the United States Supreme Court had recognized that the real party in interest in such suits is the government and that, in the past, relief could be obtained only by showing that the officer sued had acted on an invalid authorization or outside his authorization and, therefore, was not acting for the government. The court then declared:

"The doctrine is wearing thin. Recent years have witnessed a great expansion of the individual's rights to seek redress against the government for wrongs committed by it . . . Probably the two most important federal statutes waiving governmental immunity are the Federal Tort Claims Act of 1946 (28 U.S.C.A. 2674) and the statute involved in this case, the A.P.A., also passed in

THE UNIVERSITY OF CHICAGO
LIBRARY
540 EAST 57TH STREET
CHICAGO, ILL. 60637

THE UNIVERSITY OF CHICAGO
LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

THE UNIVERSITY OF CHICAGO LIBRARY

1946. By providing judicial review in an action brought by 'any person adversely affected or aggrieved by agency action' Congress permitted suits which under established tests would certainly be barred as suits against the government . . . The Act thereby makes a clear waiver of sovereign immunity in actions to which it applies. *Adams v. Witmer*, 9th Cir., 1959, 271 F. 2d 34-35. Because the waiver of immunity clears the way for recognition that the government is the real defendant, it is no longer necessary to complicate the problem by continuing the fiction that the suit is not against the government."

Estrada v. Ahrens, 296 Fed. 2d 690, 699.

It was further declared that a court of law is the proper place to test unauthorized administrative power, and that if a government officer misconstrues a statute and causes injury, the official exceeds his statutory authority.

Of course, the right of judicial review is restricted by the preamble to 5 U.S.C.A. 1009, which provides for such review, "Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion."

Ferry v. Udall, 336 Fed. 2d 706 (9th Cir. 1964) discusses this limitation and recognized that some measure of discretion is involved in almost any agency action, but that does not make the action unreviewable.

"The analytical problem is that of determining when the agency action is 'committed to agency discretion' within the meaning of Section 10 of the A.P.A. and when it merely 'involves' discretion which is nevertheless reviewable."

Ferry v. Udall, 336 Fed. 2d
706, 711.

In making this analysis, the court noted that inquiry must be directed as to whether the action requires informed discretion on matters on which experts may agree.

It is submitted that the issues involved herein are not of such a nature. Basically, appellants assert that the regulations prohibiting outside professional activity have no reasonable relation to the maintenance of proper standards of medical care in the Veterans Hospitals and that there is no evidence that resident physicians engaged in "moonlighting" have been disabled from efficiently performing their duties at the hospital.

This is not the conflict of interest situation involved in *Indiviglio v. United States*, 299 Fed. 2d 266. The latter case, incidentally, assumed the jurisdiction of the court to review rules and regulations of the F.H.A. alleged to be unreasonable. See also: *Friedman v. Schellenbach*, 159 Fed. 2d 22.

In *Ferry v. Udall*, *supra*, 336 Fed. 2d 706, at page 713, it was further noted that "courts entertain suits to determine whether the regulations promulgated to administer the Act are consistent with the mandatory requirements of the Act." See also:

Farmers v. Philadelphia Electric Co., 328 Fed. 2d 3 (3rd Cir. 1964);

Williamson v. Holland, 232 Fed. Supp. 479 (U.S.D.C. E.D. N.C., 1963);

Air Line Pilots Ass'n, Int. v. Quesada, 182 Fed. Supp. 595 (U.S. D.C. SD, N.Y., 1960);

First National Bank of Smithfield, North Carolina v. Saxon, 352 Fed. 2d 267 (4th Cir. 1965).

Review of the legislation relating to the Veterans Administration additionally demonstrates Congressional intent to provide judicial review in the area involved in the instant case. Thus, with respect to claims for benefits or payments under any law administered by the Veterans Administration, the decision of the Administrator is made final and conclusive "and no other official or any court of the United States shall have power or jurisdiction to review any such decision." (Emphasis added - 38 U.S.C.A. 211(a).)

Nowhere, however, in sections 4108 or 4115, prescribing

the authority of the Administrator to issue regulations, does such language appear. Nor is there any similar provisions in section 4110 providing for disciplinary boards to hear and determine charges of inefficiency or misconduct of persons employed as appellants are. Section 4110(d) merely provides that:

"The decision of the Administrator shall be final."

Pursuant to section 4110(e), the Administrator is empowered to delegate a part of this authority to the Chief Medical Director, with right of appeal to the Administrator, "but in the absence of such an appeal, the decision of the Chief Medical Director shall have the same force and effect as a decision of the Administrator."

CONCLUSION

Of course, no doctor is compelled to work for the Veterans Administration, and he is free to practice medicine elsewhere if he objects to employment under regulations requiring him to work 24 hours a day, seven days a week, and to refrain from outside employment. However, that fact is no justification for unreasonable, arbitrary regulations. As stated in *Adler v. Board of Education*, 342 U.S. 485, at page 491:

...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...

...the ... of ... and ...
...the ... of ... and ...

...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...

...the ... of ... and ...

...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...
...the ... of ... and ...

"It is sufficient to say that constitutional protection does extend to a public servant whose exclusion pursuant to a statute is patently arbitrary and discriminatory."

Pursuant to the Administrative Procedure Act, the appellants sought judicial review of such regulations. Appellants have suffered a "legal wrong" by reason of such regulations. They allege that they have been threatened with disciplinary action if they continue "moonlighting," have been required to discontinue outside professional activities, and have suffered loss of income by reason thereof (T. pp. 4 - 9). They have a "legally protected right to be free of the effects ascribed to the administrative determinations" (*Braude v. Wirtz*, 350 Fed. 2d 702, 707 (9th Cir. 1965)).

The order of the District Court in dismissing the action for lack of jurisdiction is erroneous and should be reversed.

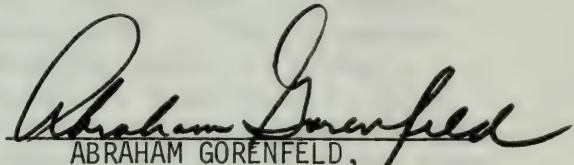
Respectfully submitted,

ABRAHAM GORENFELD

Attorney for Appellants

CERTIFICATE OF COUNSEL

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.


ABRAHAM GORENFELD,
Attorney for Appellants

DECLARATION OF INTEREST

I, the undersigned, do hereby declare that I am not a member of the
Board of Directors of the [Name of the Corporation] and that I have no
direct or indirect interest in the [Name of the Corporation] or in any of its
assets or liabilities, and that I have no interest in any of the
business of the [Name of the Corporation] or in any of its
assets or liabilities.

[Signature]
[Name of the Signatory]

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA)
) ss.
County of Los Angeles)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen years and not a party to the within action or proceeding; that

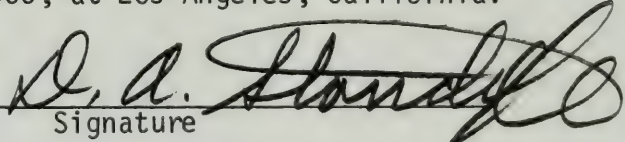
My business address is 215 West Fifth Street, Los Angeles, California 90013, that on February 7th, 1966, I served the within APPELLANTS' OPENING BRIEF (Mulry v. Driver - No. 20514) on the following named, by depositing 3 *copies* thereof, inclosed in a sealed envelope with postage thereon fully prepaid, in the United States Post Office in the City of Los Angeles, California, addressed to said party at the address as follows:

Honorable John W. Douglas
Assistant Attorney General
Civil Division
U. S. Department of Justice
Washington, D. C. 20530

Attention: M. Hollander, Chief
Appellate Section

I declare under penalty of perjury that the foregoing is true and correct.

Executed on February 7th, 1966, at Los Angeles, California.



Signature

Orig. & 20 copies: Clerk, U.S. Court of Appeals
For the Ninth Circuit
U.S. Post Office and Court House Bldg.
San Francisco, California 94101

DEAN-STANDEFER MULTI COPY SERVICE, 215 West Fifth Street
Los Angeles, California 90013 - MADison 8-6898.

APR 11 1904

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION
155 E. 42ND STREET, NEW YORK

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION
155 E. 42ND STREET, NEW YORK

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION
155 E. 42ND STREET, NEW YORK

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

[Handwritten signature]

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

THE NEW YORK PUBLIC LIBRARY
ASTOR LENOX TILDEN FOUNDATION

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHARLES MULRY, LEONARD POLONSKY, IRVIN FISHMAN,
LAWRENCE LEE, CARMEN YUPPA and ROBERT BARRETT,

Appellants,

v.

WILLIAM DRIVER, Administrator of
the Veterans Administration, et al.,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION

BRIEF FOR THE APPELLEES

JOHN W. DOUGLAS,
Assistant Attorney General,

MANUEL L. REAL,
United States Attorney,

MORTON HOLLANDER,
ROBERT V. ZENER,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

FILED

MAR 12 1966

WM. B. LUCK, CLERK

I N D E X

	<u>Page</u>
Jurisdictional statement-----	1
Statement of the case-----	2
Statutes and regulations involved-----	3
Argument	
The district court properly held that it lacked jurisdiction to review the conditions of appellants' employment.-----	6
Conclusion-----	9

CITATIONS

Cases:

Communist Party v. Control Board, 367 U.S. 1-----	9
Hargett v. Summerfield, 243 F. 2d 29 (C.A.D.C.)-----	7
Indiviglio v. United States, 299 F. 2d 266 (Ct. Cl.)-	8
Keyton v. Anderson, 229 F. 2d 519 (C.A.D.C.)-----	7
Longshoremen's Union v. Boyd, 347 U.S. 222-----	9
Powell v. Brannan, 196 F. 2d 871 (C.A.D.C.)-----	7
Saggau v. Young, 240 F. 2d 865 (C.A.D.C.)-----	7
Seebach v. Cullen, 338 F. 2d 663 (C.A. 9), certiorari denied, 380 U.S. 972-----	7
United Public Workers v. Mitchell, 330 U.S. 75-----	9
United States v. Drumm, 329 F. 2d 109 (C.A. 1)-----	8

Statutes and Regulations:

Administrative Procedure Act:

5 U.S.C. 902-----	2,9
Sec. 10, 5 U.S.C. 1009-----	2,6,7

Statutes and Regulations: (continued)	<u>Page</u>
28 U.S.C. 1291-----	2
28 U.S.C. 1331-----	2
28 U.S.C. 1346-----	2
28 C.F.R. 45.9-----	8
38 C.F.R. 1.454-----	3

Miscellaneous:

Department of Medicine and Surgery Supplement, Veterans Administration Manual, MP-5, Part II, Chapter 2-----	3
Veterans Administration Manual, MP-I, part 1, chapter 2-----	3

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20514

CHARLES MULRY, LEONARD POLONSKY, IRVIN FISHMAN,
LAWRENCE LEE, CARMEN YUPPA and ROBERT BARRETT,

Appellants,

v.

WILLIAM DRIVER, Administrator of
the Veterans Administration, et al.,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION

BRIEF FOR THE APPELLEES

JURISDICTIONAL STATEMENT

This action was brought in the United States District Court for the Southern District of California against various officials of the Veterans Administration, for the purpose of obtaining judicial review of administrative regulations regarding the conditions of employment of resident physicians employed by the Veterans Administration. (R. 2-12). Plaintiffs are resident

physicians employed at the Veterans Administration Hospital in Long Beach, California. This appeal is taken from a judgment entered October 14, 1965, granting defendants' motion to dismiss the complaint, on the ground of lack of jurisdiction.

The jurisdiction of the district court was asserted under 28 U.S.C. 1331 and 1346 and 5 U.S.C. 1009. The jurisdiction of this Court is based on 28 U.S.C. 1291.

STATEMENT OF THE CASE

Appellants, resident physicians at the Long Beach Veterans Hospital, sought a judgment declaring invalid a Veterans Administration regulation (set forth at pages 3-6 infra) prohibiting them from engaging in outside professional activities for remuneration (R. 3). Appellants alleged that this regulation violates the Fifth Amendment in that it deprives them of liberty and property without due process; is arbitrary, capricious and unreasonable; takes private property for public use without just compensation; and deprives appellants of the equal protection of the law. (R. 7-8).

Appellants also sought a declaration that 5 U.S.C. 902, which excludes residents-in-training from the statutory provision guaranteeing federal employees overtime compensation for work over 40 hours a week, denies them equal protection of the laws. (R. 8-9).

Finally, appellants attacked a Veterans Administration regulation requiring employees to refrain from discussing with

unauthorized persons matters under investigation by the Investigative Service of the Veterans Administration (R. 5-6). Appellants alleged that this regulation violates the First Amendment by depriving them of freedom of speech and the press, and the right to petition the government for redress of grievances. (R. 9).^{1/}

Appellants alleged that the salaries paid them by the Veterans Administration (which range from \$4325 to \$7715 per annum) are so inadequate that they are compelled to "moonlight." (R. 6). They further alleged that the Veterans Administration conducted an investigation into outside professional activities of the Long Beach residents (R. 4-5) and that disciplinary action has been threatened. (R. 7). Finally, they alleged that they have been warned to refrain from discussing the investigation except with the investigative personnel involved. (R. 17).

The district court granted defendants' motion to dismiss on the ground of lack of jurisdiction. (R. 51).

STATUTES AND REGULATIONS INVOLVED

Department of Medicine and Surgery Supplement, Veterans Administration Manual, MP-5, Part II, Chapter 2, provides in relevant part (R. 44-49):

b. Restrictions on Outside Professional Activities of Full-Time Physicians, Dentists,

^{1/} This regulation, referred to by appellants as "Section 204.06 of the Veterans Administration Regulations", is actually paragraph 204.06 of VA Manual MP-I, part 1, chap. 2. The regulation is based on a published regulation appearing at 38 C.F.R. 1.454.

Nurses, Residents and Interns. Full-time physicians, dentists and nurses are employed on the basis of 24 hours a day, 7 days per week. Such personnel are therefore prohibited from engaging in extra-VA professional activities for remuneration. This prohibition equally applies to residents and interns appointed under the authority of 38 U.S.C. 4114(b). Defined below are certain specific terms and conditions relating to extra-VA professional activities which are prohibited or may be permitted in keeping with the above requirement.

(1) Prohibited Activities

(a) Private Practice

1. Office practice.
2. Consultation practice, with remuneration.
3. Other conventional medical, dental or nursing practice.

(b) Private practice equivalents for purpose of Department of Medicine and Surgery employment.

1. Accepting financial remuneration, directly or indirectly, for rendering a professional, scientific, technical, or administrative service related to their profession, including teaching, from:

a. Another physician, dentist or from any hospital or clinic, including those associated with the VA through a Deans Committee relationship or otherwise;

b. A commercial concern, such as insurance company, surgical instrument, pharmaceutical, or drug firm or manufacturer, dry goods store, hotel, etc.;

c. An industrial concern, such as a coal mine, chemical plant or industry, steel plant, etc.;

d. Teaching in a medical school or other educational institution, including one affiliated with the VA hospital in which the individual is employed, and including not only teaching in undergraduate, graduate, and postgraduate instruction or in the administration of such instruction but also the instruction and administration of instruction of refresher courses, courses for technicians, etc.;

e. Operating or directing a laboratory or clinic, such as:

- (1) X-ray laboratory or clinic;
- (2) Clinical pathology laboratory;
- (3) Bacteriology laboratory;
- (4) Pulmonary function laboratory;
- (5) Radioisotope laboratory

(6) Radioisotope clinic, etc.; or serving as a consultant to such laboratories.

2. When not accepting financial remuneration, directly or indirectly:

a. When (except as a teacher) this practice serves to take the place of a physician or dentist who would otherwise have to perform the service rendered, particularly in situations such as are cited in subparagraph 1, a, b, c and e above.

b. When such action might result in:

(1) Impairing the efficiency of the VA employee in his job;

(2) Being construed as official acts of the VA when it is done by an individual in a private capacity;

(3) Criticism of, or embarrassment to, the VA.

(2) Permitted Practices

(a) Acceptance of nonmonetary awards except that a monetary award or prize from a nonprofit organization in recognition of professional achievement or other notable contribution may be accepted with the prior approval of the Chief Medical Director.

(b) Acceptance of a reimbursement for actual expenses incurred in delivering lectures, etc.

(c) Consultation. (An advisory professional opinion in isolated instances involving a single patient without remuneration or responsibility for medical care.)

(d) Performing emergency services without remuneration to those involved in an accident or other bona fide emergency.

Field station heads will report specific circumstances to the Chief Medical Director in any instance in which they are unable to secure compliance with the restrictions enumerated above.

(3) Certification. Each full-time physician, dentist and nurse will be required to sign VA Form 10-1015, Certification--Outside Practice, at entrance on duty. The signed certification will be filed in the personnel folder. A second copy of the form letter will be given to the employee.

* * * * *

Section 10 of the Administrative Procedure Act, 5 U.S.C. 1009, provides in relevant part:

"Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion.

"(a) Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

* * * * *

"(e) So far as necessary to decision and where presented the reviewing court shall * * * hold unlawful and set aside agency action, findings and conclusions found to be (1) arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; * * *"

ARGUMENT

THE DISTRICT COURT PROPERLY HELD THAT IT LACKED JURISDICTION TO REVIEW THE CONDITIONS OF APPELLANTS' EMPLOYMENT

The basic issue in this case is whether there is jurisdiction

under Section 10 of the Administrative Procedure Act, 5 U.S.C.

1009,^{2/} to review the Veterans Administration regulation prohibiting outside employment. Section 10 provides for judicial review "except so far as * * * agency action is by law committed to agency discretion." 5 U.S.C. 1009. The regulation here involved falls within that exception.

Clearly, appellants may not obtain a broader review in this declaratory judgment action than they could obtain if they were discharged for failure to comply with the regulation in question. It has been consistently held that employee discharges are not reviewable by the courts except to determine that applicable procedures have been followed, and that the discharges were in accord with controlling legislation. Seebach v. Cullen, 338 F. 2d 663 (C.A. 9), certiorari denied, 380 U.S. 972; Powell v. Brannan, 196 F. 2d 871 (C.A.D.C.); Keyton v. Anderson, 229 F. 2d 519 (C.A.D.C.); Saggau v. Young, 240 F. 2d 865 (C.A.D.C.). Thus for purposes of the Administrative Procedure Act "employee removal and discipline are almost entirely matters of executive agency discretion." Hargett v. Summerfield, 243 F. 2d 29, 32 (C.A.D.C.), certiorari denied, 353 U.S. 970. The same is true of regulations regarding the conditions of employment, for the violation of which employees may be removed or disciplined.

2/ If there were jurisdiction to review under Section 10, we would contend alternatively that the regulation meets the standards of that Section, since it is a reasonable exercise of the discretion of the Veterans Administration to regulate its conditions of employment. See discussion at page 8 infra.

In the present case, there is no question of procedural irregularity. Nor is there any allegation that applicable legislation has been misconstrued. And appellants' allegations of constitutional violations are no more than a contention that the regulation against moonlighting is arbitrary and unreasonable.

Regulations limiting or prohibiting outside employment are common in the government. Indiviglio v. United States, 299 F. 2d 266 (Ct. Cl.) (Federal Housing Administration); United States v. Drumm, 329 F. 2d 109 (C.A. 1) (Department of Agriculture). And while these regulations are frequently aimed at conflict of interest situations, they also on occasion have a broader scope. See 28 C.F.R. 45.9 (professional employees of Department of Justice). It is common knowledge that doctors -- and especially interns and residents-in-training -- work long, irregular hours, and frequently must be continuously on call. In these circumstances, it is not arbitrary and unreasonable for the Veterans Administration to conclude that resident physicians should devote their full time to their principal employment and should not take outside employment.

Appellants are not being denied the right to practice their profession; they are simply being required to confine their practice to the Long Beach Hospital as long as they remain in the resident program there. Appellants feel that this requirement -- which they agreed to upon their employment by the Veterans Administration (R. 14, 18, 21) -- is not a wise policy.

However, the wisdom and advisability of executive policies regarding the conditions of government employment are not matters for judicial inquiry.^{3/}

CONCLUSION

For the foregoing reasons, we respectfully submit that the judgment of the district court should be affirmed.

JOHN W. DOUGLAS,
Assistant Attorney General,

MANUEL L. REAL,
United States Attorney,

MORTON HOLLANDER,
ROBERT V. ZENER,
Attorneys,
Department of Justice,
Washington, D. C. 20530.

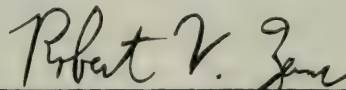
MARCH 1966

3/ Appellants allege that the regulation prohibiting discussion of investigations violates their First Amendment rights (R. 5-6, 9). We submit that this regulation is a reasonable exercise by the agency of its right to limit its employees' discussion of internal agency affairs. In any event, no case or controversy has been alleged as to this regulation, since appellants have not alleged that they have engaged or intend to engage in outside discussion of the investigation, or that there has been any threat to take any disciplinary action by reason of violations of this regulation. United Public Workers v. Mitchell, 330 U.S. 75, 86-91; Longshoremen's Union v. Boyd, 347 U.S. 222; Communist Party v. Control Board, 367 U.S. 1, 70-81.

Appellants' brief does not refer to the allegation of the complaint (R. 8-9, 11) that 5 U.S.C. 902 -- which exempts residents in training from the general provision for overtime pay -- is unconstitutionally discriminatory. Accordingly, we presume the point has been abandoned. In any event, it is clearly reasonable to place professional employees, who are in effect undergoing post-graduate training, in a different category for purposes of the 40-hour work week than most other government employees, especially in view of the well-recognized practice in the medical profession for young doctors to work long and irregular hours.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion the foregoing brief is in full compliance with these rules.



ROBERT V. ZENER

Attorney,
Department of Justice,
Washington, D. C. 20530.

PETITION FOR REHEARING

United States Court of Appeals

NINTH CIRCUIT

NO. 20514

FILED
OCT 11 1966
WM. B. LUCK, CLERK

CHARLES MULRY, LEONARD POLONSKY,
IRVIN FISHMAN, LAWRENCE LEE,
CARMEN YUPPA and ROBERT BARRETT,

Appellants,

vs.

WILLIAM DRIVER, Administrator of the
Veterans Administration, et al.,

Appellees.

Appeal from the United States District Court,
Southern District of California, Central
Division

Petition for Rehearing

ABRAHAM GORENFELD
1258 West First Street
Los Angeles, Calif. 90026
MAdison 6-6272
Attorney for Appellants

NO. 2 0 5 1 4

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHARLES MULRY, LEONARD POLONSKY,
IRVIN FISHMAN, LAWRENCE LEE,
CARMEN YUPPA and ROBERT BARRETT,

Appellants,

vs.

WILLIAM DRIVER, Administrator of
the Veterans Administration, et al.,

Appellees.

Appeal from the United States District Court
Southern District of California
Central Division

PETITION FOR REHEARING

The Appellants above-named respectfully petition this Honorable Court for a rehearing of the appeal in the above-entitled cause, and in support of this petition, represent to the Court as follows:

1. By reason of the ruling of the trial court that it lacked jurisdiction of this action, Appellants were denied an opportunity to offer evidence as to the substantive issues. Because of the absence of evidence, there has been a clear misapprehension of crucial facts by your Court.

Thus, in the printed opinion, this Court takes judicial notice, in effect, of a condition which does not exist. The opinion states that:

"(3) If a doctor resident is away at some other hospital in the midst of performing an appendectomy upon a private patient, he is not available for immediate attention to a critical case in the Veterans Hospital." (p. 9)

If evidence had been received, it would have been proved that this could not happen. The hospital administration has approved an O.D. Rotation Roster, so that each night only three resident physicians (out of approximately 110), plus one alternate and one staff physician, are required to staff the hospital and furnish around the clock care for patients from 4:30 p.m. to 8:00 a.m.

This procedure, approved by the Veterans Administration, negates the assumption that there is a rational basis for the regulation. The current practice at the hospital is inconsistent with the regulation.

2. The Court's opinion indicates that Appellants are not in training status (p. 6), but additional clarification is necessary. Appellants alleged that they were appointed pursuant to Title 38, U.S.C., Section 4114 (T. p. 3, l. 30). Said section authorizes the Administrator to employ residents on a temporary full-time or part-time basis [4114(a)(1)(A)]. It also authorizes him to establish (permanent?) residencies [4114(b)], and to establish the terms of pay.

Is there a distinction between residencies established under Section 4114(a)(1)(A) and those under Section 4114(b) with respect to being in training status?

3. The Court's opinion (footnote 5, p. 5) indicates that Appellants may be entitled to the Statutory pay scales set forth in Section 4107, Title 38, U.S.C., ignoring the declaration of that section to the effect that

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

... ..

these scales are applicable only to appointments under Section 4103.

4. Before this appeal may properly be disposed of, Appellants urge this Court to determine whether they are entitled to the coverage of Sections 911 to 922 and 944 of Title 5, U.S.C. If, in fact, they are excluded from such coverage, have Appellants been deprived of constitutional rights as alleged in the Complaint? (T. p. 7, l. 30 - p. 8, l. 5.) Appellants sought declaratory relief as to this issue (T. p. 11, ll. 5 - 13), but the question remains undetermined. Appellants urge this Court to decide the issue or to remand the case with appropriate direction.

For the foregoing reasons, this petition for rehearing should be granted.

Respectfully submitted,

ABRAHAM GORENFELD

Attorney for Appellants

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS

TO THE HONORABLE SENATE OF THE UNIVERSITY OF CHICAGO
I have the honor to acknowledge the receipt of your letter of the
10th inst. in relation to the proposed plan for the
reorganization of the University of Chicago. I am
pleased to inform you that the plan has been
approved by the Board of Trustees and the
Faculty of the University. The plan provides for
the reorganization of the University into
four divisions, each of which will be
responsible for the instruction and research
in its respective field. The plan also provides
for the establishment of a new School of
Engineering and Applied Sciences, and for
the expansion of the existing Schools of
Arts and Sciences, Business Administration,
and Education.

I am, Sir, very respectfully,
Yours very truly,
The President of the University of Chicago

Very truly yours,
The President of the University of Chicago

CERTIFICATE OF COUNSEL

STATE OF CALIFORNIA)
County of Los Angeles) ss.

ABRAHAM GORENFELD, being first duly sworn, on oath,
certifies and says:

That he is attorney for the Appellants in this cause;
that he makes this Certificate in compliance with Rule 23
of the Rules of this Court; that in his judgment, the within
and foregoing petition for rehearing is well founded and is
not interposed for delay.

ABRAHAM GORENFELD

Subscribed and sworn to before me
this day of October, 1966.

Notary Public in and for
the State of California.

STATE OF NEW YORK

IN SENATE
January 12, 1906

REPORT
OF THE
COMMISSIONER OF THE LAND OFFICE
IN RESPONSE TO A RESOLUTION
PASSED BY THE SENATE
MAY 1, 1905
AND
BY THE ASSEMBLY
MAY 1, 1905
AND
BY THE SENATE
MAY 1, 1905
AND
BY THE ASSEMBLY
MAY 1, 1905

ALBANY:

WILLIAM H. BROWN, PRINTER

1906

RECEIVED

STATE OF NEW YORK

COMMISSIONER OF THE LAND OFFICE

PROOF OF SERVICE BY MAIL

STATE OF CALIFORNIA)
)
County of Los Angeles)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Los Angeles, over the age of eighteen and not a party to the within action or proceeding; that

My business address is 215 West Fifth Street, Los Angeles, California 90013, that on October , 1966, I served the within PETITION FOR REHEARING (Mulry v. Driver - No. 20514) on the following named party, by depositing 3 copies thereof, inclosed in a sealed envelope with postage thereon fully prepaid, in the United States Post Office in the City of Los Angeles, California, addressed to said party at the address as follows:

Honorable John W. Douglas
Assistant Attorney General
Civil Division
U. S. Department of Justice
Washington, D. C. 20530
Attention: M. Hollander, Chief
Appellate Section

I declare under penalty of perjury that the foregoing is true and correct.

Executed on October , 1966, at Los Angeles, California.

D. A. Standefer

Subscribed and sworn to before me
this day of October, 1966.

Notary Public in and for
the State of California

Orig & 20 copies: Clerk, U.S. Court of Appeals, Ninth Circuit
U. S. Post Office and Court House Bldg.
San Francisco, California 94101

THE UNIVERSITY OF CHICAGO

CHICAGO, ILLINOIS

1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

THE UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1900

No. 20,548 ✓

IN THE

**United States Court of Appeals
For the Ninth Circuit**

JAMES H. GONDER and

MARY D. GONDER,

vs.

HOYT F. KELLEY,

Appellants,

Appellee.

APPELLANTS' BRIEF

COTTRELL, HOFVENDAHL & ROESSLER,

210 North Fourth Street,

San Jose, California 95112,

Attorneys for Appellants.

FILED

FEB 24 1966

WM. B. LUCK, CLERK

Subject Index

	Page
I. Statement of pleadings and jurisdictional facts	1
II. Statement of the case	2
III. Specification of errors relied upon	3
IV. Questions presented	3
V. Argument	4
A. The District Court should accept finding of fact made by the referee when the finding is based not just on the terms and provisions of a written con- tract, but is also based on the total evidentiary cir- cumstances adduced before him	4
B. Entry into an accord—executory or executed— ought not to free a debtor from the consequences of his dishonest conduct by discharging that accord in bankruptcy	9

Table of Authorities Cited

Cases	Pages
Boynton v. Ball, 121 U.S. 457.....	14
Bruning v. United States, 317 F.2d 229 (9th Cir., 1963), aff'd, 376 U.S. 358, 84 S.Ct. 906, 11 L.Ed.2d 772.....	11
Fidelity & Casualty Co. of New York v. Golombosky, 133 Conn. 317, 50 A.2d 817, 170 A.L.R. 361 (1946).....	13
Guernsey-Newton Co. v. Napier, 275 Pac. 724 (Wash., 1929)	12
Heagney v. Brooklyn E. Dist. Terminal, 190 F.2d 976 (C.A. 2d, 1951)	8
Hoppe v. Rittenhouse (9 Cir. 1960), 279 F.2d 3.....	5
Maryland Casualty v. Cushing, 171 F.2d 257 (7th Cir. 1948)	9, 10
O'Rieley v. Endicott-Johnson Corp. (8 Cir., 1961), 297 F. 2d 1	5
Taitech v. Lavoy, 360 P.2d 588 (Wash., 1961).....	13
Tucker v. Colwell, 193 U.S. 480 (1903).....	14
United States v. United States Gypsum Co. (1948), 333 U.S. 364, 68 S.Ct. 525, 92 L.Ed. 746.....	5
Zimmern v. Blount, 238 Fed. 740 (5th Cir., 1917).....	13

Statutes

Bankruptcy Act:

Section 17	2, 10, 11, 14
Section 24 (11 U.S.C. 47)	2
Section 39(c) (11 U.S.C. 67(c))	2, 3

Texts

9 Am. Jur. 2d 616	14
6 Corbin on Contracts:	
Page 71	9
Page 72, n. 4	8, 9
Page 76	7
Cowans, Bankruptcy Law and Practice, page 212	11
2 Restatement of the Law of Contracts:	
Section 417(c)	7
Section 419	7

No. 20,548

IN THE

**United States Court of Appeals
For the Ninth Circuit**

JAMES H. GONDER and

MARY D. GONDER,

Appellants,

VS.

HOYT F. KELLEY,

Appellee.

APPELLANTS' BRIEF

**I. STATEMENT OF PLEADINGS AND
JURISDICTIONAL FACTS**

This is an appeal from an order made September 21, 1965, by the United States District Court for the Northern District of California, Southern Division, determining the dischargeability of a debt owing from the bankrupt appellee, to appellant.

Appellant commenced this proceeding on October 28, 1964, by the filing of an Application to Determine Dischargeability of a Debt in the office of the Referee In Bankruptcy, Daniel R. Cowans. After hearing, the Referee determined that the debt was non-dischargeable. The bankrupt and appellee herein then petitioned the District Court for a review of the Referee's order under Section 39(c) of the Bankruptcy Act (11

U.S.C. 67(c)). After review, the District Court reversed the Referee's order; appellant's appeal from the order of the District Court under Section 24 of the Bankruptcy Act (11 U.S.C. 47).

II. STATEMENT OF THE CASE

This proceeding in bankruptcy was commenced to determine the dischargeability under Section 17(a)(2) of the Bankruptcy Act of a debt due to them from the bankrupt. The application to determine dischargeability alleged, among other acts of misconduct, that the bankrupt had comingled trust funds and converted the same to his own personal use (1 Transcript of Record 2, lines 25 through 29; hereinafter cited as TR). After a hearing on the application, the Referee held the debt to be non-dischargeable (1 TR 8-9), and found as a fact that the bankrupt had comingled trust funds with his own personal funds and converted the same to his own use and benefit (1 TR 11, lines 25-28; 1 TR 12, lines 7-10). The Referee also found as a fact:

“9. That thereafter, and on or about the 10th day of January, 1963, as a means of compromising the differences above referred to, applicants and bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., entered into an executory agreement of accord whereby bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., promised and agreed to pay the sum of \$18,444.13 at the rate of \$500.00 per month commencing March 1, 1963, in accordance with the

provisions of a written promissory note executed on or about the same date.”

The bankrupt then sought a review of the Referee’s order, alleging that the promissory note was accepted by appellants as a full compromise and release of all prior claims (1 TR 16, lines 8-25). After review, the District Court, in an opinion filed by The Honorable W. T. Sweigert on September 21, 1965, reversed the Referee’s decision and held the debt to be dischargeable on the ground that the agreement of January 10, 1963, was a waiver and discharge of the antecedent tort liability (1 TR 41-47). This appeal follows.

III. SPECIFICATION OF ERRORS RELIED UPON

1. The District Court erred in holding that the Referee In Bankruptcy was limited to the record in the Superior Court action in determining dischargeability.
 2. The District Court erred in reversing the Referee’s holding that the debt was non-dischargeable.
-

IV. QUESTIONS PRESENTED

1. Whether the District Court should accept finding of fact made by the Referee when the finding is based not just on the terms and provisions of a written contract, but also on the total evidentiary circumstances adduced before the Referee?
2. Whether entry into an accord—executory or executed—ought to free a debtor from the consequen-

ces of his dishonest conduct and discharge that obligation in bankruptcy.

V. ARGUMENT

A. THE DISTRICT COURT SHOULD ACCEPT FINDING OF FACT MADE BY THE REFEREE WHEN THE FINDING IS BASED NOT JUST ON THE TERMS AND PROVISIONS OF A WRITTEN CONTRACT, BUT IS ALSO BASED ON THE TOTAL EVIDENTIARY CIRCUMSTANCES ADDUCED BEFORE HIM.

The opinion of the District Court was based on the conclusion that the agreement of January 10, 1963, was meant to discharge the antecedent tort obligation and not merely to suspend the debt, because the bankrupt and his wife gave a valuable consideration. In reaching this conclusion, the District Court committed one of two errors: First, it overlooked or did not consider the Referee's finding of fact that the agreement of January 10th was an executory agreement of accord. That finding was set out verbatim at page 2, *supra*. Second, if the finding was considered and rejected, then such rejection was itself an error because the Referee's finding was not "clearly erroneous" within the meaning of General Order No. 47 of the General Orders in Bankruptcy. For the Referee had the benefit of actually seeing witnesses and hearing the testimony in arriving at his conclusion that the agreement of January 10, 1963, was executory.

General Order in Bankruptcy No. 47 provides:

"Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions

of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.”

This standard is to be applied to the Referee’s findings.

Hoppe v. Rittenhouse (9 Cir. 1960), 279 F.2d 3, 7;

O’Rieley v. Endicott-Johnson Corp. (8 Cir., 1961), 297 F.2d 1, 4.

The duty of the District Court to accept the findings of fact of the Referee is mandatory, unless those findings are clearly erroneous. The United States Supreme Court has defined the “clearly erroneous” standard as follows:

“A finding is ‘clearly erroneous’, when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.”

United States v. United States Gypsum Co. (1948), 333 U.S. 364, 68 S. Ct. 525, 542, 92 L.Ed. 746, 766.

In their application to determine dischargeability, appellants in paragraph XVIII alleged:

“That thereafter and on or about the 10th day of January, 1963, as a means of compromising their differences above referred to, applicants and bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., entered into an execu-

tory agreement of accord whereby bankrupt and his wife, Lois J. Kelley, and Century Enterprises, Inc., promised and agreed to pay the sum of \$18,444.13 at the rate of \$500.00 per month commencing March 1, 1963, in accordance with the provisions of a written promissory note executed on or about the same date." (TR 6)

At the hearing on this matter, the allegation was never disputed, the *fact* that the agreement was executory rather than executed was never questioned at all. About the only direct reference to the agreement itself during the entire hearing occurred during an argument concerning the relevance of appellee's bank records. At page 53, lines 9 through 16, the allegations were read into the record, and at page 55, lines 16 and 17, reference to the actual agreement of January 10, 1963, was made. In the face of the allegations and the argument, neither the bankrupt nor his counsel ever questioned the executory nature of the agreement. The entire thrust of bankrupt's argument was concerned with limiting the evidence to the Superior Court record. The bankrupt did not ever argue that the signing of the agreement operated in and of itself as a fully executed accord and satisfaction. At no place in the record of the hearing before the Referee is such a contention even hinted at.

Viewed realistically and against the background of these parties' circumstances, it was clear to the Referee that Dr. Gonder was not interested in any promise of any nature made by Hoyt Kelley at any time. The doctor was solely interested in getting his

money back. That is to say, he was interested solely in Mr. Kelley's performance of the promise to pay.

Thus, from the entire evidence adduced before him, the Referee concluded as a fact that the agreement was executory and embodied that conclusion in his finding of fact No. 9. Such a finding, of course, permits appellant herein to enforce the original tort obligation; for when a debtor breaks an executory agreement of accord the creditor has alternative rights. He can enforce either the original duty or the subsequent contract, 2 Restatement of the Law of Contracts, Sec. 417(c); 6 Corbin on Contracts, 76 ("There is unlimited authority to the effect that an accord executory, providing for a future discharge of a claim, is not itself a present discharge.")

In doubtful cases, the Restatement of Contract provides a canon of interpretation or construction in Section 419:

"Where a contract is made for the satisfaction of a pre-existing contractual duty, or duty to make compensation, the interpretation is assumed in case of doubt, if the pre-existing duty is an undisputed duty either to make compensation or to pay a liquidated sum of money, that only performance of the subsequent contract shall discharge the pre-existing duty; but if the pre-existing duty is of another kind, that the subsequent contract shall immediately discharge the pre-existing duty, and be substituted for it."

While the District Court takes the position in its Opinion at page 6 (1 TR 46) that the bankrupt and his wife gave valuable consideration in that they made

themselves personally liable for what was a former debt of the corporation, that is too facile a resolution of the problem. In point of fact, there never was a dispute about the bankrupt's obligation to repay this debt. The only question was how much the payments would be and when they would be made. On this question, Professor Corbin states that "If an agreement is a compromise of a disputed claim, it is perhaps *more likely* to be declared by the court to be a substituted contract." 6 Corbin on Contracts, 72 n 4. However, he also states:

"The term 'accord executory' is and always has been used to mean an agreement for the future discharge of an existing claim by a substituted performance. In order for an agreement to fall within this definition, *it is the promised performance that is to discharge the existing claim*, and not the promise to render such performance. Conversely, all agreements for a future discharge by a substituted performance are accords executory. *It makes no difference whether or not the existing claim is liquidated or unliquidated, undisputed or disputed*, except as these facts bear upon the sufficiency of the consideration for some promise in the new agreement . . ." (Emphasis added.)

These comments were cited with approval in *Heagney v. Brooklyn E. Dist. Terminal*, 190 F.2d 976, 979 (C.A.2d, 1951), where the court states:

"Quite in point, therefore is Professor Corbin's enlightening discussion of compromise agreements and their connection with executory accords. Thus, he says: 'By thinking and speaking in

terms of compromise the existing befuddlement in regard to executory accords is avoided.' . . . Hence as he points out, there may be a compromise furnishing an agreed upon substitute for performance which, in turn, may require specific performance, although generally it may be reasonably clear that the parties intend a discharge 'only when the compromise performance is rendered.' " 6 Corbin on Contracts, 71-72, n 4.

The point here is that the Referee had before him the "entire evidence", and decided that Doctor Gonder was interested in Mr. Kelley's performance, not his promise. That is to say, that the Referee decided that the accord agreement was executory rather than executed or a substituted contract. On the evidence, and in light of the above canons of construction the Referee's finding on that issue of fact should be binding on the District Court. The District Court, therefore, erred in substituting its own findings on that issue of fact, and accordingly, the order of the District Court should be reversed.

**B. ENTRY INTO AN ACCORD—EXECUTORY OR EXECUTED—
OUGHT NOT TO FREE A DEBTOR FROM THE CONSEQUENCES OF HIS DISHONEST CONDUCT BY DISCHARGING
THAT ACCORD IN BANKRUPTCY.**

In its opinion, the District Court adopted the rule enunciated by the Seventh Circuit in *Maryland Casualty v. Cushing*, 171 F.2d 257 (7th Cir., 1948) (1 TR 46, lines 23-25). The District Court then held that it was error for the Referee to go behind the accord

agreement of January 10, 1963, and the note given pursuant thereto. In the *Cushing* case, *supra*, the accord agreement was oral but was found as a matter of fact by the trial judge that at the time the parties entered into the accord agreement and delivered a promissory note in consideration thereof, that the creditor promised and agreed to waive the tort action. Thus, the case held as a matter of law that the tort liability had been satisfied and discharged by the execution of the note and that the indebtedness upon the note in turn was barred by the discharge in bankruptcy. 171 F.2d 257, 259.

In this argument appellant proposes to meet the rule of the *Cushing* case head-on and to petition this Court to adopt a different rule. The *Cushing* case turns on a technical question of the law of contracts—whether an accord agreement is executory or executed. In the case before this Court, we have two lower courts disagreeing about that technical question. While appellants contend that an executory agreement was intended, in this argument appellant also takes the position that the question of dischargeability ought not to turn on technical points in the law of contracts, but that the question of dischargeability should be determined in light of the policy underlying Section 17 of the Bankruptcy Act.

The second clause of Section 17 of the Bankruptcy Act provides as follows:

“a discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . .

(2) or liabilities or obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining the extension or renewal of credit in reliance upon a materially false statement respecting his financial condition made or published in any manner whatever with intent to deceive, or for wilful and malicious injuries to the person or property of another . . .”

In his recent work on Bankruptcy Law and Practice, the Referee who heard this case below has set out the policy reasons for Section 17:

“The policy of relief to beleaguered debtors is a highly important one in bankruptcy. It is considered of a high order of importance to give unfortunate debtors a fresh start and return them to useful production. This policy is not so important, however, as to negative other important policies which the law feels a responsibility to foster and abet. In general, the two bases of policy upon which the exceptions of Section 17 of the Act appear to be founded are . . . (2) that the relief of discharge is intended for the honest and thus certain debts created by the debtor’s unlawful or oppressive conduct should remain his obligations.” Cowans, Bankruptcy Law and Practice, p. 212.

That policy is well known to this Court. In *Bruning v. United States*, 317 F.2d 229, 231 (9th Cir., 1963), affirmed, 376 U.S. 358, 84 S.Ct. 906, 11 L.Ed.2d 772, Circuit Judge Chambers, speaking for the court, said:

“Section 17, (a) is not a compassionate section for debtors. Congress, speaking for society, has

decided that the problems of others: the government, the abandoned-dependent wife, the defrauded widow, override the value of giving the debtor a wholly new start in life." *Ibid.*, p. 231.

In light of this policy, appellant most earnestly contends that dischargeability should be determined from the original character of the act on which the liability is based, regardless of the intervening steps the creditor may take to reduce his claim to money. There is persuasive support for this point of view in the cases. In *Guernsey-Newton Co. v. Napier*, 275 Pac. 724 (Wash., 1929), the Supreme Court of Washington said:

"... The fact that the appellant wrote the respondent a letter and enclosed a note for him to sign covering the obligation has no material bearing upon the question, *and would not have had even though the note had been signed and reduced to judgment.* In a bankruptcy proceeding it is the original character of the liability which determines whether it is dischargeable. In order to determine the original character of the liability the courts will look behind the judgment if the obligation has been reduced to judgment.

"In *Donald v. Carroll*, 111 Ind. 1, 11 N.E. 782, it is said: 'Where the enforcement of a judgment is sought to be defeated by a discharge in bankruptcy, it is proper to look behind it to the character of the debt upon which it is founded; and if it is ascertained that it belongs to a class upon which the discharge does not operate, the judgment will be enforced.' " (Emphasis added.)

The *Napier* case was recently cited with approval in *Taitch v. Lavoy*, 360 P.2d 588 (Wash., 1961).

In *Zimmern v. Blount*, 238 Fed. 740 (5th Cir., 1917), the Circuit Court of Appeals for the Fifth Circuit stated that

“the plaintiff has the right to proceed upon a note and at the same time seek to enforce his alleged cause of action for deceit. They are in no sense inconsistent remedies . . .” (p. 745)

There is, of course, the contrary view of the *Cushing* case, *supra*, in the 7th Circuit, and there is language stating the contrary view in the leading state court case on the point, *Fidelity & Casualty Co. of New York v. Golombosky*, 133 Conn. 317; 50 A.2d 817, 820, 170 A.L.R. 361, 365 (1946). An annotation on the point is set out at 170 A.L.R. 368; “*Character of original claim as non-dischargeable as preventing discharge in bankruptcy of judgment on note given therefor*,” and the editors of that annotation state:

“Thus, it has been generally held that a claim which is not dischargeable under the provision of the Bankruptcy Act is not rendered dischargeable by the recovery of a judgment thereon. In such case the judgment itself is not dischargeable.” *ibid*, p. 368.

The editors of American Jurisprudence 2d have also taken the position that this is a better rule:

“Persuasive reasons support this view. A creditor should not be placed in the dilemma of foregoing his right to assert an exception to discharge either by the act of accepting a note from the debtor or by securing the rendition of a judgment

on the note. He is in no sense attacking the judgment by introducing extrinsic evidence of the non-dischargeable character of the original obligation. The rendition of a judgment does not involve the issue of whether the debt is one dischargeable in bankruptcy." 9 Am.Jur.2d 616.

Indeed, in all of the cases which permit the creditor to prove the dishonest character of the original debt by evidence extraneous to the record of any judgment, the courts in effect are holding that a mere change of form involved in reduction of the claim to a judgment should not be permitted to thwart the application of the policy underlying Section 17 of the Bankruptcy Act. *Tucker v. Colwell*, 193 U.S. 480 (1903); *Boynton v. Ball*, 121 U.S. 457, 466. The question presented in the case at Bar is whether the bankrupt himself should be permitted to thwart that policy by entering into a contract of accord. Appellants contend that he should not, and that the question of dischargeability should turn on the original character of the acts giving rise to the liability, namely that of a wilful and malicious injury to the property of another. For that reason, appellants respectfully urge the reversal of the District Court's order.

Dated, San Jose, California,
February 24, 1966.

Respectfully submitted,

COTTRELL, HOFVENDAHL & ROESSLER,
By JOHN N. NORMAN,
Attorneys for Appellants.

CERTIFICATION

I certify that in connection with the preparation of this Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Dated, February 24, 1966.

JOHN N. NORMAN

No. 20,548 ✓

IN THE

**United States Court of Appeals
For the Ninth Circuit**

JAMES H. GONDER and
MARY D. GONDER,

Appellants,

vs.

HOYT F. KELLEY,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE NORTHERN DISTRICT OF
CALIFORNIA, SOUTHERN DIVISION.

BRIEF FOR APPELLEE

WATSON, TEDESCO & SANGUINETTI,

By RICHARD B. SANGUINETTI,

1276 Lincoln Avenue,
San Jose, California,

Attorneys for Appellee.

FILED

JUN 10 1966

WM. B. LUCK, CLERK

TOPICAL INDEX

	page
Jurisdictional Statement.	2
Statement of the Case.	3
Questions Presented.	8
Argument.	9
I.—The District Court's decision is fully supported by substantial evidence and applicable law.	9
A. The facts support the conclusion that the compromise agreement of January 10, 1963 was a novation agree- ment.	9
B. A novation agreement completely extinguishes the antecedent tort claim for all purposes, including proceedings under Bankruptcy Act, Section 17 a(2). ..	16
C. Even assuming this Court determines the parties did not enter into a novation agreement, proceedings under Bankruptcy Act, Section 17 a(2) are properly limited to the record in the Superior Court action.	17
II.—The District Court did not err in rejecting the Referee's Finding No. 9.	19
III.—The District Court did not err in holding the Bank- rupt's debt to appellants discharged on the ground that the antecedent tort claim was extinguished by the novation agreement.	22
Conclusion.	23
Certification.	24

TABLE OF AUTHORITIES CITED

Cases

	page
<i>Aetna Cas. and Surety Co. v. Bettins</i> (S.D. Cal 1953) 111	
F. Supp 111	11, 13, 16, 22
<i>Alexander v. Angel</i> (1951) 37 Cal 2d 856, 236 Pac 2d	
561	10, 13, 16
<i>Carr v. Southern Pacific Company</i> , 128 F 2d 764 (C.A. 9) ..	20
<i>Fidelity and Casualty Co. of New York v. Golombosky</i>	
(1946) 133 Conn. 317, 50 A 2817	23
<i>Hargadine-McKittrick Dry Goods v. Hudson</i> (C.C. Mo.	
1901) 111 Fed 361	17
<i>Maryland Casualty Co. v. Cushing</i> , 171 F 2d 257 (C.A.	
7)	12, 16, 22, 23
<i>National Finance Co. of Provo v. Daley</i> (1963) 14 Utah	
2d 263, 382 Pac 2d 405	17
<i>Olympic Finance Co. v. Thyret</i> , 337 F 2d 62 (C.A. 9)	
.....	11, 13, 16, 20
<i>Utley v. United States</i> , 304 F 2d 746 (C.A. 9)	20

Statutes

Bankruptcy Act:

Section 17 a	2, 9, 17
Section 24 (11 USC 47)	2
Section 39 c (11 USCA 67 c)	2
General Order in Bankruptcy, No. 47	19

Codes

California Civil Code:

Section 168	15
Section 171	15
Section 1530	10
Section 1531	10
Section 1532	10

Texts

15 Am. Jur. 2d, page 935	17
15 Am. Jur. 2d, page 938	17
3 Collier, Bankruptcy (14th ed. 1964) Section 63.07	15

No. 20,548

IN THE

**United States Court of Appeals
For the Ninth Circuit**

JAMES H. GONDER and
MARY D. GONDER,

Appellants,

vs.

HOYT F. KELLEY,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE NORTHERN DISTRICT OF
CALIFORNIA, SOUTHERN DIVISION.

BRIEF FOR APPELLEE

JURISDICTIONAL STATEMENT.

This is an appeal from the September 21, 1965 decision of the United States District Court for the Northern District of California, Southern Division, holding the debt owing from bankrupt appellee to appellants dischargeable under Section 17 a(2) of the Bankruptcy Act. (1 TR 41).

On August 24, 1964 the Bankrupt filed his petition in Bankruptcy, duly scheduling therein a debt to Appellants. Appellants filed their unverified Application to Determine Dischargeability of Debt on October 28, 1964. (1 TR 1). In a decision of February 26, 1965, the debt of the Bankrupt to Appellants was held by the Referee to be a willful and malicious injury to the property of another within the meaning of the Bankruptcy Act Section 17 a(2), and thus not dischargeable. (1 TR 9).

A Petition for Review was duly filed by the Bankrupt Appellee pursuant to Bankruptcy Act, Section 39 (c) and 11 USCA 67 (c) (1 TR 15). After review, the District Court, in an opinion filed by the Honorable W. T. Sweigert on September 21, 1965, reversed the Referee's decision and held the debt to be discharged on the ground that the compromise agreement of January 10, 1965, constituted a novation whereby the antecedent tort obligation was extinguished. (1 TR 45-47).

Appellants appeal from the District Court decision pursuant to Bankruptcy Act, Section 24 and 11 USC 47.

STATEMENT OF THE CASE.

Appellants statement of the case is sketchy and incomplete. Accordingly, Appellee will set forth herein a more detailed statement of all facts considered by the District Court as important to the determination of this case.

On September 1, 1960, and at all times important herein, the Bankrupt was president of Century Enterprises, Inc., (hereinafter referred to as "Century"), a California corporation, and one Earl J. Messier was vice-president of said corporation. The Bankrupt and Messier were the sole owners and managers of Century. (2 TR 47, 62, 63). On the above date the Bankrupt and Messier, acting on behalf of Century, entered into an agreement with Appellants which provided that Appellants deliver funds to Century to be used by it to secure an inventory of trust deeds, that Century would maintain said funds in a trust account at a bank and not withdraw said funds except upon simultaneous assignment to Appellants of valid promissory notes secured by deeds of trust in the amount of withdrawal, and that Appellants would receive a return of 20% interest on their funds deposited with Century. (Objectors Exhibit 7, being Exhibit B of Bankrupt's Answer to Superior Court Action No. 151227; 2 TR 47). At the time of this agreement Appellants deposited \$6,000.00 with Century and on September 6, 1960, they deposited the further sum of \$1,500.00 with Century. (2 TR 49).

On October 21, 1960, the Bankrupt and Messier, both acting on behalf of Century, entered into an agreement of modification with Appellants whereby the agreement of September 1, 1960, was modified. (Objector's Exhibit 7; 2 TR 49). Under the modification, the Appellants transferred eleven promissory notes and deeds of trust to Century and Century agreed to credit the sum of \$25,957.51 to the trust account of Appellants. This modification also provided that Century would pay Appellants 20% interest per annum on Appellants balance of \$33,475.51 in monthly payments of \$567.79. (Objector's Exhibit 7; 2 TR 62).

From November 1, 1960 to May 1, 1962, Appellants received \$567.79 monthly for a total of \$10,788.01. Thereafter, Century failed to make any further payments to Appellants. (2 TR 90). The Bankrupt repeatedly denied converting to his own use any of the funds deposited by Appellants with Century (2 TR 61, 62, 64, 65, 68, 69); the Referee found, and the District Court accepted said finding as true, that the Bankrupt failed to deposit and maintain the funds of Appellants in a trust account at a bank, but commingled said funds with his own personal funds and converted the same to his own personal use and benefit. (1 TR 9, 42).

On January 10, 1963, the Bankrupt and his wife, Lois Kelley, and Century Enterprises, Inc., entered into an Agreement with Appellants in order "to amicably settle the matters existing between them and to avoid litigation." In the execution of this Agreement,

Appellants had the benefit of advice by their own attorney. (Objector's Exhibit 7, being Exhibit A to Bankrupt's Answer in Superior Court Action No. 151227).

The Agreement provides that the Bankrupt and his wife in their individual capacities, and Century Enterprises, Inc., shall make, execute and deliver to Appellants their promissory note in "the sum of \$18,443.13, payable at \$500.00 per month or more, including interest at the rate of ten (10%) percent interest on the declining balance from January 1, 1963, with installments due on the first day of each and every month, commencing February 1, 1963." (Objector's Exhibit 7). The Agreement also contained the following provisions which, because of their importance on the issue of novation, are set forth at length below:

"2. That in consideration of the terms, conditions and covenants of this agreement, First Parties (Appellants) *do* for themselves, their heirs, executors, administrators and assigns, *agree* with Second Parties (Appellee, his wife, and Century), their heirs, executors, administrators and successors, that *neither of First Parties will apply or jointly institute any suit, action at law or equity or proceeding against Second Parties or any of them, nor in any way, institute or prosecute any claim, demand action or cause of action for such claim, damage, loss, recovery or expense of any nature arising out of the transaction between First Parties and Second Parties hereinabove referred to* (referring to Agreements of September 1, 1960 and October 21, 1960 between Appellants and Century). No provision herein shall, however, in any manner be construed or intended to limit, affect or impair the right of First Parties to act upon the promissory note

agreed to be delivered by the terms of this agreement in the event of a failure of the Second Parties to make the payments as provided for therein, including attorney fees and court costs.”

“3. Nothing, however, contained in this agreement shall deprive First Parties from proceeding with any action which they may deem advisable upon that certain Bond No. S 26-08-34 issued by the Indemnity Company of North America, indemnifying Century Enterprises, Inc. from any losses sustained by reasons of any action of their employees in the use of funds belonging to others . . . It is specifically understood that this agreement may not be pleaded as either a complete or partial defense to any action or other proceeding that First Parties may take upon the bond. . . .” (Emphasis added).

Pursuant to the aforesaid Agreement, Appellants accepted the note and the Bankrupt and his wife made payments to Appellants of \$500.00 per month from March 1, 1963, through July 1, 1963. (Objector’s Exhibit 6, being Appellants’ complaint in Superior Court Action No. 151227). The Bankrupt and his wife defaulted on said promissory note, and on November 15, 1963, Appellants commenced Action No. 151227 in the Superior Court of the State of California, in and for the County of Santa Clara, pleading only the promissory note and non-payment thereof. (Objector’s Exhibit 6; 1 TR 6). The Bankrupt and his wife answered and raised the affirmative defense that the promissory note included interest at a usurious rate, namely twenty (20%) percent per annum. (Objector’s Exhibit 7). Before trial, the usury defense, a stay of execution, and possible bankruptcy were discussed. (2 TR 87, 88, 92). The parties then entered into a

stipulation for Judgment whereby it was agreed that the Bankrupt, his wife, and Century have judgment against them for "the sum of \$16,842.41 principal, interest from July 1, 1963, to date at seven (7%) percent per annum amounting to \$717.71, \$2,000.00 attorneys fees and \$34.50 costs. (Objector's Exhibit 5). On February 11, 1964, Judgment was entered in favor of Appellants and against the Bankrupt, his wife, and Century for \$20,094.62. (Objector's Exhibit 8).

After the Referee's decision holding the Bankrupt's debt to Appellants to be non-dischargeable was filed, the Appellants filed a Memorandum of Costs and Disbursements in Superior Court Action 151227, listing a Sheriff's fee for levy on real property. The Bankrupt then learned that Appellants caused a Writ of Execution to be issued on November 4, 1964, caused a levy to be made on property allegedly owned by the Bankrupt, bid \$5,000.00 for the Bankrupt's alleged interest in said property, and received the Sheriff's Certificate of Sale in January, 1965. When the Bankrupt opposed the cost bill, Appellants stipulated to a \$5,000.00 reduction in their Judgment. (1 TR 33). In their Memorandum of Points and Authorities to the District Court on the Petition for Review, Appellants agreed that the foregoing facts relative to pressing their Judgment to execution sale be considered by the District Court. (1 TR 40).

The Bankrupt sought a review of the Referee's Order contending among other grounds, that the agreement of January 10, 1963, was intended by the

parties as a full compromise and settlement of all claims arising under the agreements of September 1, 1960 and October 21, 1960. (1 TR 26, lines 3-6; 30, lines 31, 32). The District Court reversed the Referee's decision and held the debt to Appellants discharged on the ground that the compromise agreement of January 10, 1963, constituted a novation, whereby the Appellants accepted the note of Bankrupt and his wife in discharge of the antecedent tort claim. (1 TR 45, 47). This Appeal followed.

QUESTIONS PRESENTED.

The questions presented on this appeal are the following:

I. Whether the District Court's Decision is fully supported by substantial evidence and applicable law.

II. Whether the District Court erred in rejecting the Referee's Finding No. 9.

III. Whether the District Court erred in holding the Bankrupt's debt to Appellants discharged on the ground that the antecedent tort claim was extinguished by the novation agreement.

It is respectfully submitted that the District Court did not err and that its decision should be affirmed for the reasons set forth in the following argument.

ARGUMENT.**I.****THE DISTRICT COURT'S DECISION IS FULLY SUPPORTED BY SUBSTANTIAL EVIDENCE AND APPLICABLE LAW.**

Appellee submits that the District Court's decision is fully supported by substantial evidence and applicable law. Appellee will establish the following points in support of the District Court decision:

A. The facts support the conclusion that the compromise agreement of January 10, 1963, was a novation agreement.

B. A novation agreement completely extinguishes the antecedent tort claim for all purposes, including proceedings under Bankruptcy Act, Section 17 a(2).

C. Even assuming this Court determines the parties did not enter into a novation agreement, proceedings under Bankruptcy Act, Section 17 a(2) are properly limited to the record in the Superior Court action.

A. The facts support the conclusion that the compromise agreement of January 10, 1963 was a novation agreement.

After setting forth the pertinent evidence in the record compromising the dealings, agreements and lawsuits between Appellants and the Bankrupt, the

District Court concludes that the compromise agreement of January 10, 1963, was intended by the parties to be, and is in fact, an express novation, whereby the Appellants accepted the promissory note of the Bankrupt and his wife in discharge of the tort liability of the Bankrupt:

“In the instant case the note and agreement of January 10, 1963, contains *express language of novation, namely the substitution of the note for the (appellants’) agreement not to institute or prosecute any claim, damage, loss, recovery or expense of any nature* arising out of the transaction between First Parties (Appellants) and Second Parties (Bankrupt, his wife, and Century) hereinabove referred to. *According to the agreement, the remedy of (Appellants) is restricted to an action upon the promissory note if the bankrupt defaults.* Inasmuch as there is no evidence in the record to support any other interpretation, the Court concludes that the intent of this agreement was not merely to evidence or suspend the debt, but to discharge the antecedent tort action.” (Emphasis added) (1 TR 45).

What constitutes a novation? California Civil Code Sections 1530 and 1532 state that a novation is the substitution by agreement of a new obligation for an existing one, with intent to extinguish the latter. The substitution may be (1) of a new obligation between the same parties; or (2) of new parties, either new debtor, or new creditor. California Civil Code, Section 1531. A novation completely extinguishes the original obligation and a failure to perform the new one does not revive the old. *Alexander v. Angel* (1951) 37 Cal 2d 856, 236 Pac 2d 561. The *Alexander* case, *supra*, is the leading California case on the requisites and legal

effect of a novation; the Court there in affirming the trial Court's finding that a novation had in fact been intended and effected, stated at 236 Pac 2d, pages 564-565:

"Where it satisfactorily appears that a new agreement was intended by the parties to take the place of an existing one, as is the case there since the parties proceeded to act for some fifteen months in reliance solely on the substituted agreement, it necessarily follows that the old agreement has been entirely abrogated or extinguished In consequence of such novation, the rights and duties of the parties must be governed by the new agreement alone, and a failure to perform thereunder does not, under any theory of rescission or revivor, operate to breathe new life into the dead and extinguished obligation."

The United States Court of Appeals for the Ninth Circuit discussed the requisites and legal effect of a novation when affirming the District Court in *Olympic Finance Co. v. Thyret* (9th Cir 1964) 337 Fed 2d 62. The Court contrasted the respective rights and obligations of the parties before and after the execution of the novation agreement and held the agreement in question to be a novation.

In *Aetna Cas. and Surety Co. v. Bettins* (1953) 111 Fed Supp 111, the United States District Court, Southern District of California, held that where a surety on the principal's tax abatement bond paid the principal's taxes and, instead of bringing an action against the principal on the theory of subrogation to the rights of the United States, took the principal's note, a new obligation had been substituted for an

existing one and that the note accepted by the surety was discharged by the principal's discharge in bankruptcy. At page 113, the Court states:

"It is noted that throughout the statutes and case law respecting a novation that the intent of the parties is a controlling factor. The Court cannot reconcile the conduct of the parties in this action with an intent to stand by the original cause of action. The fact that the surety allowed the statute of limitations to run thereon and accepted a promissory note, which when not paid on the due date, was succeeded by a new promissory note, and in turn, by others, all without reference to the original obligation, indicates that plaintiff intended to substitute the promissory note for an obligation implied in law By its acceptance of the note plaintiff accepted defendant's offer to substitute a new obligation with different and definite incidents in place of the old It gave the plaintiff certain additional rights including a definite contracted rate of interest and a right to collection costs in the event of suit on the note"

In the leading case of *Maryland Casualty Co. v. Cushing* (7th Cir. 1948), 171 F 2d 257, plaintiff, surety in favor of defendant's employer, paid the employer \$14,970.00 which sum had been embezzled by defendant, and thereby became subrogated to the right to sue defendant for conversion. Instead of suit for the conversion, plaintiff accepted defendant's note. When defendant filed bankruptcy, he claimed that plaintiff orally agreed to waive the antecedent tort in exchange for defendant's executing the note. The Court held that the note was given in consideration of plaintiff's waiver of the antecedent tort claim, that the tort claim

had been satisfied and discharged, and that the indebtedness on the note was barred by the discharge in bankruptcy. Although the Court speaks in terms of Accord and Satisfaction, rather than novation, the controlling factor is whether the parties bargained to substitute a new obligation for an antecedent tort claim.

To ascertain the intent of the parties, the Courts look to the terms of the agreement and to the conduct of the parties subsequent to the agreement. *Alexander v. Angel, supra*; *Olympic Finance Co. v. Thyret, supra*; *Aetna Cas. and Surety v. Bettins, supra*.

The compromise agreement of January 10, 1963, quoted at length in the Statement of the case and by the District Court in its opinion, contains express language of novation, whereby Appellants accept the note of the Bankrupt and his wife and Appellants do agree not to "institute or prosecute any claim, damage, loss, recovery or expense of any nature arising out of the transaction between First Parties (Appellants) and Second Parties (Bankrupt, his wife and Century) hereinabove referred to." (Objector's Exhibit 7). The language is absolute, not conditional upon Appellees payment in accordance with the terms of the note. In fact, the agreement restricts the remedy of Appellants to an action on the note if the Bankrupt defaults. (Objector's Exhibit 7, last sentence of paragraph 2). Moreover, Appellants reserve certain rights to proceed on the Century Enterprises, Inc. bond. (Objector's Exhibit 7, paragraph 3). Further, the preamble to the Agreement recites that by the execution of this Agree-

ment the parties intend to settle their disputes and avoid litigation. In short, the language of the Agreement compels a conclusion that, rather than bringing suit against the Bankrupt for the alleged conversion of funds, Appellants agreed to waive and forego that disputed claim, comprised the matter, and accepted a definite legal obligation in the form of an interest bearing note executed by the Bankrupt in his individual capacity and his wife. Appellants can hold new parties as a result of this novation agreement, since the Bankrupt's wife becomes obligated and the Bankrupt makes himself personally liable for what was a debt of the corporation, Century. In addition the note provides for a set rate of interest and attorneys fees in the event of default.

Appellants did not testify as to their intention in executing the Agreement of January 10, 1963, or at all. However, their actions clearly show that they regarded the promissory note as the measure of their rights against the Bankrupt. The Bankrupt and his wife paid and Appellants accepted \$500.00 per month from March 1, 1963, through July 1, 1963. On November 15, 1963, Appellants commenced Superior Court Action No. 151227 pleading only the terms of said note and non-payment thereof. (Objector's Exhibit 6). Appellants did not plead conversion. When the parties entered into a Stipulation for Judgment, the Stipulation confessed judgment on the note and no attempt was made to classify the indebtedness as arising from a conversion. (Objector's Exhibit 5). Likewise the judgment is silent on the matter of con-

version. (Objector's Exhibit 8). Even after the hearing before the Referee and before his decision, Appellants pursued their legal remedies on the Superior Court Judgment by sale under a writ of execution. All of the foregoing conduct of Appellants over a period in excess of two years show that they looked to the Bankrupt on his note only.

The Bankrupt and his wife gave valuable consideration in return for Appellants' agreement to waive the conversion cause of action. The Bankrupt made himself personally liable for what was a debt of the corporation, Century. The signing of the agreement and note by the Bankrupt's wife made her separate property and earnings liable for the debt. California Civil Code, Sections 168 and 171. The Bankrupt regarded Appellants claim as disputed, contending he had not converted funds and that the claim was subject to the defense of usury. In compromising the matter, he surrendered these defenses. Likewise, the Bankrupt's personal undertaking may constitute a loss to the Bankrupt of the defense that Century had paid a usurious rate of interest to Appellants. See 3 Collier, Bankruptcy Section 63.07 at 1822-1824, 14th ed. 1964). In light of the foregoing, the discharge of the antecedent tort claim of Appellants was amply supported by consideration from the Bankrupt and his wife.

In view of the foregoing facts, Appellee submits that the Court was correct in holding that the compromise agreement of January 10, 1963, was a novation agreement and that the antecedent tort claim was extinguished thereby. Indeed, the express language of the

compromise agreement makes the instant case stronger factually than the *Cushing* case, *supra*, or the *Aetna* case, *supra*.

B. A novation agreement completely extinguishes the antecedent tort claim for all purposes, including proceedings under Bankruptcy Act, Section 17 a(2).

The legal effect of a novation agreement is to completely extinguish the original obligation. In consequence of such an agreement, the rights and duties of the parties must be governed by the new agreement alone. *Alexander v. Angel*, *supra*; *Olympic Finance Co. v. Thyret*, *supra*.

Since the antecedent tort obligation is extinguished, it follows that it is improper to consider the antecedent tort claim in proceedings under Bankruptcy Act, Section 17 a(2). *Maryland Casualty Co. v. Cushing*, *supra*; *Aetna Cas. and Surety Co. v. Bettens*, *supra*.

There are persuasive reasons for this rule. First, the Court should honor the bargain of the parties, rather than to destroy their agreement by revivor of the antecedent debt. Secondly, many novations including the one at issue are in reality compromise and settlement agreements of disputed claims. A "compromise" is an agreement to terminate, by means of mutual concessions, a claim which is disputed in good faith or unliquidated; it is an amicable method of settling or resolving bonafide differences or uncertain-

ties and is designed to prevent or put an end to litigation. 15 Am Jur 2d, page 935. The law favors the resolution of controversies through compromise and settlement rather than through litigation; and the Courts have considered it their duty to encourage rather than to discourage parties in resorting to compromise as a mode of adjusting conflicting claims. 15 Am Jur 2d, page 938. By honoring the terms of the compromise agreement in proceedings under Section 17 a(2), the Courts are merely following their established policy of encouraging settlement of litigation.

C. Even assuming this Court determines the parties did not enter into a novation agreement, proceedings under Bankruptcy Act, Section 17 a(2) are properly limited to the record in the Superior Court action.

In the hearing before the Referee and in the hearing before the District Court, Appellee has contended that there should be a limit to the scope of inquiry in proceedings under Section 17 a(2). Although the Courts are not uniform in their decisions, Appellee contends that the better reasoned cases are found in the majority view which allows evidence beyond the judgment in a prior case to an examination of the entire record in the prior case, but no inquiry outside that record.

National Finance Co. of Provo v. Daley (1963)
14 Utah 2d 263, 382 P2 405;

Hargadine-McKittrick Dry Goods Co. v. Hudson
(C C Mo 1901) 111 Fed 361.

No good reason exists why the creditor should not be required to preserve his rights in the first action he files and prosecutes to judgment. Similarly no good reason exists why the Bankrupt should twice resist the creditors claim. In the instant case Appellants' claim arose in 1960 or 1961. Instead of preserving his claim as a non-dischargeable debt, he enters into the January 10, 1963, compromise agreement, accepts a note and payments thereon, sues on the note alone, takes judgment on the note alone, and executes on the judgment. It is only when Appellee files bankruptcy that he decides to urge an alleged conversion occurring in 1960. Appellee submits that Appellants should be estopped to go outside the record in the prior action.

II.

**THE DISTRICT COURT DID NOT ERR IN REJECTING
THE REFEREE'S FINDING NO. 9.**

Appellants have contended that General Order No. 47 cast a mandatory duty on the District Court to accept the Referee's finding that the agreement of January 10, 1963, was an executory accord, and that it was error for the District Court to conclude that said agreement was a novation. Appellants further argue that the Referee was better able to determine the nature of the January 10, 1963, agreement because he had before him the "entire evidence." Appellees do not agree with either argument.

This Court is aware of its legitimate scope of review of a Referee's decision. It is not as restricted as Appellants would have one believe. General Order in Bankruptcy No. 47 grants broad powers to the Appellate Courts.

"Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his *findings of fact* unless clearly erroneous. The judge after hearing may adopt the report or *may modify it or may reject it in whole or in part* or may receive further evidence or may recommit it with instructions." (Emphasis added).

The Appellate Courts have a broad area of review where, (1) the credibility of witnesses is not a factor and (2) where the proper interpretation of an agreement is in issue.

Carr v. Southern Pacific Company (9th Cir 1942)
128 F 2d 764.

In *Olympic Finance Co. v. Thyret, supra*, this Court, in affirming the District Court's determination that the agreement in issue was novation, stated at page 68:

"Much can be said in the case at bar for a higher degree of appellate review in light of the absence of any need to judge the credibility of witnesses before the referee; the reviewing court is in an equally advantageous position to make factual inferences from an agreed-upon set of events Reluctance is not encountered with regard to a factual conclusion from given facts. In the latter case, the proper conclusion from given facts can be made by the trial judge or the Court of Appeals, as well as the referee."

In the instant case, the proper interpretation of the January 10, 1963 agreement was in issue. Appellants did not testify regarding it, or at all. Consequently, the District Court could determine the nature of that agreement equally as well as could the Referee.

It is established appellate principle that the "unless clearly erroneous" standard does not apply to *conclusions of law*. *Utley v. United States* (9th Cir. 1962) 304 F 2d 746. The Referee stated in Finding of Fact No. 9 that the January 10, 1963 agreement was an executory accord. (1 TR 6). Although labeled a finding of fact, Appellee submits this was in reality a conclusion of law on the nature of the agreement. Therefore, it was proper for the District Court to reject such erroneous conclusion of law.

No useful purpose would be served to discuss Appellants citations to the Restatement of Contracts and excerpts from the works of Professor Corbin. The Court is aware of the distinctions between an executory accord, an accord and satisfaction and a novation. Suffice it to say that the Referee erred by concluding that the January 10, 1963 agreement was an executory accord; it was and is a novation agreement for the reasons stated in the learned opinion of the District Court.

III.

**THE DISTRICT COURT DID NOT ERR IN HOLDING
THE BANKRUPT'S DEBT TO APPELLANTS DIS-
CHARGED ON THE GROUNDS THAT THE ANTE-
CEDENT TORT CLAIM WAS EXTINGUISHED
THROUGH THE NOVATION AGREEMENT.**

Appellants argue that dischargeability of a debt should always be determined from the original character of the act on which the liability is based, regardless of the intervening steps the creditor may take to reduce his claim to money. (A.O.B. page 12). They choose to ignore the rights of the debtor and creditor to compromise and settle their disputes. They choose to ignore the prerogative of the parties to substitute a new well-defined obligation in place of antecedent disputed claim and thereby effect a novation or an accord and satisfaction. They choose to ignore the well-reasoned holding of the *Maryland Casualty* case and the *Aetna Cas. and Surety Co.* case. They urge this Court to adopt a rule wherein the creditor cannot be held to have waived the antecedent tort claim no matter what agreements he may enter and no matter what concessions he may obtain from the Bankrupt. Obviously the rule they urge would destroy the right to freely contract and would put an end to bonafide compromise and settlement agreements.

The cases cited Appellants for this novel position do not support it. None of the cases cited at pages 12 and 13 of Appellants' brief deal with the effect of a

creditors' execution of a novation or an accord and satisfaction. They merely held that inquiry can be made behind the judgment into the entire record in a prior action. *Fidelity and Casualty Co. of New York v. Golombosky* (1946) Conn. 317, 50 A 2d 817, holds that inquiry can be made to evidence outside the record in the prior action; however, it did not involve a compromise agreement in the nature of an novation or an accord and satisfaction; it is not, therefore, contrary to the holding of *Maryland Casualty Co., supra*, nor is it support for Appellants novel contention.

In summary, Appellee submits that the District Court properly held Bankrupt's debt to Appellants discharged on the ground that the antecedent tort claim was extinguished upon the execution of the January 10, 1963 novation agreement.

CONCLUSION.

It is respectfully submitted that for the foregoing reasons the decision of the District Court must be affirmed.

Respectfully submitted,

WATSON, TEDESCO & SANGUINETTI,
By RICHARD B. SANGUINETTI,
Attorneys for Appellee.

CERTIFICATION

I certify that in connection with the preparation of this Brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

Dated, June 10, 1966.

RICHARD B. SANGUINETTI

**In the United States Court of Appeals
for the Ninth Circuit**

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

**SULLY-MILLER CONTRACTING COMPANY, AND CON-
STRUCTION TEAMSTERS UNION, LOCAL 606, RE-
SPONDENTS**

**On Petition for Enforcement of an Order of the
National Labor Relations Board**

**BRIEF FOR THE NATIONAL LABOR RELATIONS
BOARD**

ARNOLD ORDMAN,
General Counsel,

DOMINICK L. MANOLI,
Associate General Counsel,

MARCEL MALLET-PREVOST,
Assistant General Counsel,

SOLOMON I. HIRSH,
HERMAN M. LEVY,
Attorneys,

National Labor Relations Board.

FILED
FEB 14 1930

WILLIAM B. LORAN, CLERK

INDEX

	Page
Jurisdiction	1
Statement of the case	2
I. The Board's findings of fact and conclusions of law	2
A. Background	2
B. The discharge of Lucero	4
II. The Board's order	6
Argument	7
I. Substantial evidence supports the Board's findings that the Company violated Section 8 (a) (3) and (1) of the Act by discharging Valentin Lucero and that the Union violated Section 8 (b) (2) and (1) (A) of the Act by causing the Company to discharge Lucero because of his lack of union membership	7
II. The Board's remedy is reasonable and proper.....	13
Conclusion	15
Appendix A	16
Appendix B	19

AUTHORITIES CITED

Cases:

<i>N.L.R.B. v. Alaska Steamship Co.</i> , 211 F. 2d 357 (C.A. 9)	13
<i>N.L.R.B. v. Biscayne Television Corp.</i> , 337 F. 2d 267 (C.A. 5)	14
<i>N.L.R.B. v. Buitoni Foods Corp.</i> , 298 F. 2d 169 (C.A. 3)	11
<i>N.L.R.B. v. Cantrall</i> , 201 F. 2d 853 (C.A. 9), cert. den., 345 U.S. 996	7
<i>N.L.R.B. v. Combined Century Theatres</i> , 278 F. 2d 306 (C.A. 2)	7

Cases—Continued

Page

<i>N.L.R.B. v. Die & Tool Makers Lodge No. 113</i> , 231 F. 2d 298 (C.A. 7), cert. den., 352 U.S. 833..	8
<i>N.L.R.B. v. Eclipse Lumber Co.</i> , 199 F. 2d 684 (C.A. 9)	7
<i>N.L.R.B. v. Gluek Brewing Co.</i> , 144 F. 2d 847 (C.A. 8)	13
<i>N.L.R.B. v. Intern. Ass'n of Heat & Frost Insu- lators</i> , 261 F. 2d 347 (C.A. 1)	7
<i>N.L.R.B. v. Intern. Ass'n of Machinists, Local No. 504</i> , 203 F. 2d 173 (C.A. 9)	7
<i>N.L.R.B. v. Intern. Bro. of Elec. Workers</i> , 301 F. 2d 824 (C.A. 9)	8
<i>N.L.R.B. v. Intern. Longshoremen's & Warehouse- men's Union, Local 10</i> , 214 F. 2d 778 (C.A. 9)..	7
<i>N.L.R.B. v. Intern. Union of Operating Engineers</i> , <i>Local 12</i> , 323 F. 2d 545 (C.A. 9)	11
<i>N.L.R.B. v. Interurban Gas Co.</i> (C.A. 6), No. 14961, decided Dec. 22, 1965, 61 LRRM 2052.....	14
<i>N.L.R.B. v. W. B. Jones Lumber Co.</i> , 245 F. 2d 388 (C.A. 9)	7
<i>N.L.R.B. v. C. Malone Trucking, Inc.</i> , 278 F. 2d 92 (C.A. 1)	8
<i>N.L.R.B. v. Pinkerton's Nat'l Detective Agency</i> , 202 F. 2d 230 (C.A. 9)	13
<i>N.L.R.B. v. Puerto Rico S. S. Ass'n</i> , 211 F. 2d 274 (C.A. 1)	13
<i>N.L.R.B. v. Radcliffe</i> , 211 F. 2d 309 (C.A. 9), cert. den., 348 U.S. 833	8
<i>N.L.R.B. v. Ronney & Sons</i> , 206 F. 2d 730 (C.A. 9), cert. den., 346 U.S. 937	11
<i>N.L.R.B. v. Star Pub. Co.</i> , 97 F. 2d 465 (C.A. 9)..	13
<i>N.L.R.B. v. Swinerton</i> , 202 F. 2d 511 (C.A. 9), cert. den., 346 U.S. 814	7
<i>N.L.R.B. v. Texas Indep. Oil Co.</i> , 232 F. 2d 447 (C.A. 9)	11
<i>N.L.R.B. v. G. W. Thomas Drayage & Rigging Co.</i> , 206 F. 2d 857 (C.A. 9)	7
<i>N.L.R.B. v. Trumbull Asphalt Co.</i> , 327 F. 2d 841 (C.A. 8)	14

Cases—Continued

Page

<i>N.L.R.B. v. U. S. Air Conditioning Corp.</i> , 336 F. 2d 275 (C.A. 6)	14
<i>N.L.R.B. v. Walton Mfg. Co.</i> , 369 U.S. 404	8
<i>N.L.R.B. v. Waterfront Employers</i> , 211 F. 2d 946 (C.A. 9)	13
<i>Radio Officers' Union v. N.L.R.B.</i> , 347 U.S. 17.....	7
<i>J. A. Utley Co. v. N.L.R.B.</i> , 217 F. 2d 885 (C.A. 6)	13

Statute:

National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, <i>et</i> <i>seq.</i>)	1
Section 7	6
Section 8 (a) (1)	2, 7
Section 8 (a) (3)	2, 7
Section 8 (b) (1) (A)	2, 7
Section 8 (b) (2)	2, 7

**In the United States Court of Appeals
for the Ninth Circuit**

No. 20584

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

**SULLY-MILLER CONTRACTING COMPANY, AND CON-
STRUCTION TEAMSTERS UNION, LOCAL 606, RE-
SPONDENTS**

**On Petition for Enforcement of an Order of the
National Labor Relations Board**

**BRIEF FOR THE NATIONAL LABOR RELATIONS
BOARD**

JURISDICTION

This case is before the Court upon the petition of the National Labor Relations Board, pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151, *et seq.*) to enforce its order issued against Sully-Miller Contracting Company, and Construction Teamsters Union, Local 606, on June 16, 1965. The

Board's decision and order (R. 41-45)¹ are reported at 152 NLRB No. 159. This Court has jurisdiction of the proceeding, the unfair labor practices having occurred in California where respondent Company is engaged in the manufacture of asphalt and in the construction of roads and streets.

STATEMENT OF THE CASE

I. The Board's Findings of Fact and Conclusions of Law

The Board found that the Union violated Section 8 (b) (2) and 8(b) (1) (A) of the Act by causing the Company to discharge Valentin Lucero for lack of union membership, and that the Company violated Section 8(a) (3) and (1) of the Act by its discharge of Lucero. The facts upon which these findings are based are set forth below.

A. Background

In May 1962, the Associated General Contractors of America, Southern California Chapter, and Teamster Joint Council No. 42 and Teamsters Local 87, executed a 3-year master collective bargaining agreement on behalf of its member contractors and local unions. Respondent Company and Teamster Local 692, which in May 1962 represented Company driv-

¹ References to the pleadings, decision and order of the Board, and other papers reproduced as "Volume I, Pleadings," are designated "R." References to portions of the stenographic transcript reproduced pursuant to Court Rules 10 and 17 are designated "Tr." References preceding a semicolon are to the Board's findings; those following are to the supporting evidence. "G.C. Ex." refers to exhibits of the General Counsel.

ers, were covered by this negotiated agreement (R. 16-17; G.C. Ex. 2).²

This agreement provided in relevant part that the local union would maintain an exclusive hiring hall which the Company must first utilize when seeking employees (R. 41, 17; G.C. Ex. 2). The agreement further included a union security provision which required that workmen employed by the Company become Union members within 8 days of hiring (R. 41; G.C. Ex. 2).

In July 1962, the Company hired Valentin Lucero as a laborer and within 3 weeks assigned him to work as a truckdriver (R. 42, 18; Tr. 63-64). Lucero was hired directly by the Company and not through the local union's hiring hall. Lucero was not a union member nor did he become a member within 8 days as prescribed by the master labor agreement (R. 42, 21; Tr. 79).

Shortly after Lucero was hired, Company General Superintendent John Crosby requested from Local 692's business agent, Newey, that Lucero be granted union membership. The request was refused (R. 42, 21; Tr. 28, 32). Local 692 did not in any manner protest the fact that Lucero had been hired directly by the Company and Lucero continued in his job (Tr. 77).

About a year later, in August 1963, Newey informed Crosby that Lucero could join the Union (R.

² Local 606, respondent in the instant case, was not in existence at this time but as shown *infra*, succeeded to Local 692's jurisdiction and assumed its contract obligations.

42, 21; Tr. 32, 35). At this time, however, Lucero was not working because of an industrial accident and he did not apply for membership (R. 42, 21; Tr. 85, 87). When Lucero returned to work in November 1963, he called Newey with respect to becoming a union member, was told that the opportunity to join had passed but to keep in touch with Newey (R. 42, 21; Tr. 87, 88).

B. The discharge of Lucero

In October 1963, respondent Union, Local 606, was chartered. (R. 42, 17; Tr. 103.) Respondent Union succeeded Local 692 as the collective bargaining representative of respondent Company's truck-drivers, and assumed the administration of the collective bargaining agreement (R. 42, 17; Tr. 19, 35, 105-106).

In January 1964, respondent Union's business agent, C. E. Mitchell, contacted Lucero and inquired as to whether he was a member of respondent Union (R. 42, 18; Tr. 66-67). Lucero replied that he was not a member but indicated his willingness to join the Union (R. 42, 18; Tr. 67). Later that same day, Mitchell, accompanied by Company Foreman Kastner, informed Lucero that it was all right for him to continue working for the Company and if any union official should question his non-membership, Lucero should tell him that the "Union business agent was working on getting [Lucero] into the Union" (R. 42, 18; Tr. 68-70).

Shortly thereafter, on January 23, 1964, at the suggestion of Company Assistant Superintendent

Wilks, Lucero tendered to respondent Union via Wilks \$60 for his membership initiation fee (R. 42, 19; Tr. 70, 92). On January 27, Foreman Kastner returned this money to Lucero and reported that Mitchell "could not permit [him] to become a member of the Union" (R. 42, 19; Tr. 71-72).

Kastner sent Lucero to see Superintendent Crosby. Crosby informed Lucero that Mitchell had insisted that he be fired because of his lack of union membership (R. 42, 19; Tr. 73). Crosby advised Lucero to see Mitchell and "get things straightened out" and "when you get things straightened out, your job will be waiting for you" (R. 42, 19; Tr. 73, 42).³

Later the same day Lucero met with Mitchell at the Union office and tendered the initiation fee, which Mitchell refused (R. 42, 19; Tr. 73-74). When Lucero inquired why he could not become a union member, Mitchell replied only that Mitchell's "boss had gotten two or three calls from somebody saying I was working for Sully-Miller, not being a union member" (R. 43, 19; Tr. 75). Later in the same day, after having visited the National Labor Relations Board, Lucero returned to Mitchell and made a second tender of the initiation fee, which was again refused. When Lucero informed Mitchell that he had talked to the NLRB about this matter, Mitchell remarked, "Well if that's the type of guy you are, get out of

³ Crosby testified that Mitchell had visited him on January 27 and told him that respondent Union would not admit Lucero into membership. Mitchell informed Crosby that "we could not continue to hire Lucero as a truckdriver and if we continued to do so he would shut the job down" (R. 19; Tr. 41).

here. I don't want to talk to you" (R. 43, 19; Tr. 97).

On these facts, the Board concluded that the Company violated Section 8(a)(3) and (1) by discharging Lucero and that the Union violated Section 8(b)(2) and (1)(A) by causing the Company to discharge Lucero because of his lack of union membership (R. 43).

II. THE BOARD'S ORDER

The Board's order directs the Company to cease and desist from the unfair labor practice found and in any like or related manner interfering with, restraining or coercing its employees in the exercise of their Section 7 rights. Affirmatively, the order directs the Company to offer Lucero immediate and full reinstatement to his former position or to a substantially equivalent one. The Union is also ordered to cease and desist from the unfair labor practice found and in any like or related manner causing the Company to discriminate against employees and restraining or coercing employees in the exercise of their Section 7 rights. The order also requires that the Company and Union jointly and severally make Lucero whole for any loss of pay suffered as a result of the discrimination. The order further includes the usual posting and notice requirements (R. 43-44).

ARGUMENT

I. Substantial Evidence Supports the Board's Findings That the Company Violated Section 8(a)(3) and (1) of the Act by Discharging Valentin Lucero and That the Union Violated Section 8(b)(2) and (1)(A) of the Act by Causing the Company to Discharge Lucero Because of His Lack of Union Membership

The law is well settled that where, in the absence of a valid union security agreement, a union causes an employer to discharge an employee for lack of union membership, the employer violates Section 8(a) (3) and (1) of the Act and the union violates Section 8(b) (2) and (1) (A) of the Act. *Radio Officers' Union v. N.L.R.B.*, 347 U.S. 17, 40-42; *N.L.R.B. v. W.B. Jones Lumber Co.*, 245 F. 2d 388, 390 (C.A. 9); *N.L.R.B. v. G.W. Thomas Drayage and Rigging Company*, 206 F. 2d 857, 859 (C.A. 9); *N.L.R.B. v. International Longshoremen's and Warehousemen's Union, Local 10*, 214 F. 2d 778, 779 (C.A. 9); *N.L.R.B. v. International Association of Heat and Frost Insulators*, 261 F. 2d 347, 350 (C.A. 1); *N.L.R.B. v. Swinerton*, 202 F. 2d 511, 514 (C.A. 9), cert. denied, 346 U.S. 814; *N.L.R.B. v. Cantrall*, 201 F. 2d 853, 855-856 (C.A. 9), cert. denied, 345 U.S. 996; *N.L.R.B. v. Combined Century Theatres*, 278 F. 2d 306, 309 (C.A. 2). And even in situations where a valid union security agreement exists, a union may not seek the discharge of an employee except for the employee's failure to pay union dues and initiation fees. *N.L.R.B. v. International Association of Machinists, Local No. 504*, 203 F. 2d 173, 175 (C.A. 9); *N.L.R.B. v. Eclipse Lumber Co.*, 199 F. 2d 684 (C.A. 9);

N.L.R.B. v. Die and Tool Makers Local No. 113, 231 F. 2d 298, 302-303 (C.A. 7), cert. denied, 352 U.S. 833.

In the instant case, the Board found that the Union caused the Company to discharge Lucero and that the basis for this discharge was Lucero's lack of union membership rather than for other reasons alleged by the Company and Union. These findings are based upon the Trial Examiner's credibility resolutions which were adopted by the Board and which, as this Court has long noted, are for determination by the trier of facts and are not to be lightly overturned. *N.L.R.B. v. International Brotherhood of Electrical Workers*, 301 F. 2d 824, 827-828 (C.A. 9); *N.L.R.B. v. Radcliffe*, 211 F. 2d 309, 315 (C.A. 9), cert. denied, 348 U.S. 833; *N.L.R.B. v. Malone Trucking*, 278 F. 2d 92, 95 (C.A. 1); see *N.L.R.B. v. Walton Mfg. Co.*, 369 U.S. 404, 406-408.

That Lucero's discharge was related to union membership and his lack thereof as found by the Board is fully borne out by substantial evidence in the record. The various conversations involving Lucero, the Union and the Company reveal how, from the very beginning, Lucero's continued employment was bound to the question of union membership and how his ultimate discharge resulted from the fact that he was not a union member. Thus, the record shows that in his initial conversation with Lucero in January 1964, Union Business Agent Mitchell's first inquiry was whether Lucero was a member of the Union. When Mitchell learned that Lucero was not a union man but that Lucero was interested in joining, Mitchell stated

that he would work on getting Lucero union membership. Lucero later attempted to assure membership by tendering the necessary initiation fee. The tender was rejected and Lucero was informed by Foreman Kastner that the Union would not permit him to become a member. Pursuing this matter further, Lucero spoke to Superintendent Crosby and was told that the Union had ordered that Lucero be discharged because he was not a union member. When, as a last resort, Lucero spoke to Mitchell and again sought to tender his initiation fee, it was again rejected with an explanation that Mitchell's "boss had gotten two or three calls from somebody saying that [Lucero] was working for Sully-Miller, not being a union member." It seems clear from Mitchell's final remarks to Lucero and from the previous conversations, that the Union's unhappiness with Lucero stemmed from the fact that he was not a union member but had nevertheless been employed by the Company for almost 2 years, and that it was these facts which irked the Union and caused it to seek his discharge for lack of membership and at the same time deny him admission to the Union.

Before the Board, the Union did not deny that it caused the Company to discharge Lucero but sought to defend its actions by reliance on contract provisions which it contends serve as a valid basis for Lucero's discharge. The Union argued that the union security clause in its contract requires that an employee become a union member and remain a member as a "condition of employment." Although it is true that a union security agreement would permit a

union to request an employee's discharge if he failed to tender his dues or initiation fees, it can hardly be contended in the instant case that the Union may rely on this provision as a defense to Lucero's discharge when the Union repeatedly barred Lucero from becoming a union member and complying with the contract provision.

Nor can the Union argue that because Lucero was not originally hired in 1962 through the Union's referral system, the Union may use this reason to deny him admission to the Union and cause his discharge for lack of membership. Such an argument directly contravenes the specific language of the Act, which makes the failure to pay dues and initiation fees the only valid basis for an employee's discharge under a union security agreement.

There is no merit to the further contention that Lucero was lawfully discharged because he was hired outside the Union referral system in violation of the collective bargaining agreement; the Board found as a fact, on the evidence set forth in the statement, that it was Lucero's lack of union membership and not the manner in which he was hired 18 months earlier which was the true reason for his discharge. Even assuming that the Company's hiring of Lucero may have breached its contract with the Union, it would appear from the facts in this case that the predecessor union waived the Company's breach and that respondent Union, in assuming the administration of the same contract, is bound by its predecessor's waiver. Finally, even assuming that it could be concluded

that a breach of contract would permit the Union to seek Lucero's discharge and that this breach had not been waived, the existence of a possible additional valid motive for the discharge does not make for less of a violation of the Act where the facts show that one reason for the discharge, Lucero's lack of membership, was violative of the Act. *N.L.R.B. v. Texas Independent Oil Co.*, 232 F. 2d 447, 450 (C.A. 9); *N.L.R.B. v. L. Ronney & Sons*, 206 F. 2d 730, 737 (C.A. 9), cert. denied, 346 U.S. 937; *N.L.R.B. v. Buitoni Corp.*, 298 F. 2d 169, 174 (C.A. 3).

Nor does this Court's decision in *N.L.R.B. v. International Union of Operating Engineers, Local 12*, 323 F. 2d 545, require a different result in the instant case. In *Local 12* the question presented was whether the National Agreement or the AGC contract was applicable to the hiring of employee Sands. The AGC contract provided for an exclusive hiring hall while the National Agreement did not. The Board found that the National Agreement was applicable and that accordingly Sands' discharge was unlawful. This Court disagreed, holding that the AGC contract applied and this contract with its hiring hall provision afforded a proper justification for the discharge of Sands, who had not been hired pursuant to the hiring hall provision. In that case, as distinguished from the instant one, the Board had not made a finding that Sands was discharged because of lack of union membership. Indeed, the Board made a specific finding in *Local 12* that Sands had not been discharged for lack of union membership. In the instant case, the Board found on the basis of the credited testi-

mony that it was Lucero's non-membership which was the basis for his discharge, and not that he had been hired directly by the Company outside the hiring hall.

The Company, like the Union, relied before the Board upon the contract as a defense to its discharge of Lucero. This defense, however, is equally without merit. It is clear that the Company, knowing that the Union would not admit Lucero to membership and that this denial of admission was not based on Lucero's failure to tender dues or initiation fee, is prohibited by Section 8(a)(3) of the Act from relying on the union security provision as a justification for Lucero's discharge.

Nor does it appear reasonable under the circumstances of the instant case to permit the Company to justify Lucero's discharge by characterizing this discharge as an attempt to rectify its breach of contract in hiring Lucero 18 months earlier. The record makes apparent that the Company was satisfied with Lucero as an employee and undisturbed by any possible breach it may have committed until the Union questioned Lucero's union status and ordered the Company to discharge him because of his lack of union membership. It is perhaps understandable how an employer faced with the prospect of trouble with its union, which is the chief supplier of its work force, may well find it more expedient to sacrifice the continued employment of a single employee, than to cause any disturbance in its relationship with the union. Nevertheless, the Act protects individuals from loss of employment where the discharge is improperly

bound to the employee's union status; difficult as the Company's position may be, its responsibility not to engage in discrimination prohibited by the Act is plain. See *N.L.R.B. v. Star Publishing Co.*, 97 F. 2d 465, 470 (C.A. 9); *N.L.R.B. v. Gluek Brewing*, 144 F. 2d 847, 853-854 (C.A. 8).

II. The Board's Remedy Is Reasonable and Proper

As we have shown, *supra*, substantial evidence supports the Board's findings that the Company and Union violated the Act by conduct resulting in Lucero's discharge. In such circumstances, an appropriate remedial order consists, *inter alia*, of reinstatement of the wrongfully discharged employee and his reimbursement for monies lost as a result of the unfair labor practice. The Board's order in the instant case including such provisions is both reasonable and proper to remedy the violation found. *N.L.R.B. v. Pinkerton Detective Agency*, 202 F. 2d 230, 231-232 (C.A. 9); *N.L.R.B. v. Waterfront Employers*, 211 F. 2d 946, 955 (C.A. 9); *N.L.R.B. v. Alaska S. S. Co.*, 211 F. 2d 357, 360 (C.A. 9); *J.A. Utley Co. v. N.L.R.B.*, 217 F. 2d 885, 886 (C.A. 6); *N.L.R.B. v. Puerto Rico S. S. Association*, 211 F. 2d 274, 276 (C.A. 1).

It is anticipated that respondents may argue that reinstatement should be denied in the instant case because Lucero can be discharged for not having secured his job initially through the Union's hiring hall. In support of this argument, respondents may rely on cases in which reinstatement of the discriminatee was denied because of events occurring subsequent to his

discharge, such as misconduct or a change in the employer's economic situation. See, e.g., *N.L.R.B. v. Biscayne Television Corp.*, 337 F. 2d 267, 268 (C.A. 5); *N.L.R.B. v. Trumbull Asphalt Co.*, 327 F. 2d 841, 844-846 (C.A. 8). Reliance on those cases, however, is misplaced. In the instant case, the alleged lawful basis for Lucero's discharge did not arise subsequent to his discharge but existed—and was known by respondents to exist—at the time his employment was terminated for not being a member of the Union. Thus, under the guise of merely disputing the remedy, respondents are actually challenging the Board's finding that Lucero was discharged because of his non-membership in the Union, in violation of the Act. See *N.L.R.B. v. Biscayne Television Corp.*, *supra*; *N.L.R.B. v. U.S. Air Conditioning Co.*, 336 F. 2d 275 (C.A. 6); *N.L.R.B. v. Interurban Gas Co.* (C.A. 6), No. 14961, decided December 22, 1965, 61 LRRM 2052. As was shown, *supra*, it was Lucero's lack of union membership which was the motivating factor in his discharge and not the method by which he was hired. If the facts found had been otherwise, a different case would have been presented to the Board. In view of the facts of the instant case, however, an unlawful discharge has been established and the Board's issued order which properly remedies this violation by directing that the discriminatees be reinstated with backpay is entitled to enforcement.

CONCLUSION

For these reasons, the Board respectfully requests that its order be enforced in full.

ARNOLD ORDMAN,
General Counsel,

DOMINICK L. MANOLI,
Associate General Counsel,

MARCEL MALLET-PREVOST,
Assistant General Counsel,

SOLOMON I. HIRSH,
HERMAN M. LEVY,
Attorneys,

National Labor Relations Board.

February 1966.

CERTIFICATE

The undersigned certifies that he has examined the provisions of Rules 18 and 19 of this Court and in his opinion the tendered brief conforms to all requirements.

MARCEL MALLET-PREVOST
Assistant General Counsel
National Labor Relations Board

APPENDIX A

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*) are as follows:

RIGHTS OF EMPLOYEES

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a) (3).

UNFAIR LABOR PRACTICES

Sec. 8(a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * *

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization: *Provided*, That nothing in this Act, or in any other statute of the United States, shall preclude an employer from making an agreement with a labor organization (not established, maintained, or assisted by any action defined in section 8(a) of this Act

as an unfair labor practice) to require as a condition of employment membership therein on or after the thirtieth day following the beginning of such employment or the effective date of such agreement, whichever is the later, (i) if such labor organization is the representative of the employees as provided in section 9(a), in the appropriate collective-bargaining unit covered by such agreement when made, and (ii) unless following an election held as provided in section 9(e) within one year preceding the effective date of such agreement, the Board shall have certified that at least a majority of the employees eligible to vote in such election have voted to rescind the authority of such labor organization to make such an agreement: *Provided further*, That no employer shall justify any discrimination against an employee for nonmembership in a labor organization (A) if he has reasonable grounds for believing that such membership was not available to the employee on the same terms and conditions generally applicable to other members, or (B) if he has reasonable grounds for believing that membership was denied or terminated for reasons other than the failure of the employee to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership;

* * * *

(b) It shall be an unfair labor practice for a labor organization or its agents—

(1) to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 7: *Provided*, That this paragraph shall not impair the right of a labor organization to pre-

scribe its own rules with respect to the acquisition or retention of membership therein; or (B) an employer in the selection of his representative for the purposes of collective bargaining or the adjustment of grievances;

(2) to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a) (3) or to discriminate against an employee with respect to whom membership in such organization has been denied or terminated on some ground other than his failure to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership;

* * * *

APPENDIX B

Pursuant to Rule 18(2)(f) of the Rules of the Court
Exhibits in Board Case Nos. 21-CA-5755 and 21-CB-2252
(Numbers are to Pages of the Reporter's Transcript)

GENERAL COUNSEL'S EXHIBITS

<u>No.</u>	<u>Identified</u>	<u>Offered</u>	<u>Received in Evidence</u>
1 (a) - (i)	6	6	6
2	16	20	21
3	30	—	—
4	79	—	—

No. 20584

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

SULLY-MILLER CONTRACTING COMPANY AND CON-
STRUCTION TEAMSTERS UNION, LOCAL 606,

Respondents.

BRIEF FOR RESPONDENT SULLY-MILLER
CONTRACTING COMPANY.

DILLAVOU & COX,
C. C. DILLAVOU,
GEORGE M. COX,

611 Wilshire Boulevard,
Los Angeles California,

*Attorneys for Respondent,
Sully-Miller Contracting Company.*

FILED

APR 19 1966

WM. B. LUCK, CLERK

No. 20584

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

SULLY-MILLER CONTRACTING COMPANY AND CON-
STRUCTION TEAMSTERS UNION, LOCAL 606,

Respondents.

BRIEF FOR RESPONDENT SULLY-MILLER CONTRACTING COMPANY.

SPECIFICATION OF ERROR.

To require Respondent Employer to reinstate Lucero with back-pay is not an appropriate remedy where Lucero's original hiring employment was in violation of a lawful exclusive hiring hall agreement.

ARGUMENT.

Lucero was hired in violation of the contract and was as guilty of the violation as his employer was. In order to remedy the violation, he was, at the instance of the union, discharged. The Board has found that the discharge was unlawfully discriminatory and though we

feel that conclusion is questionable, the more important issue is the "Remedy". The Board would require Respondent Employer to reinstate Lucero with back-pay. We submit that Lucero should not be allowed to profit from his own wrong by being reinstated and rewarded with back-pay in connection with a job that he had secured improperly in the first instance. When Lucero was discharged, he lost nothing to which he was entitled.

Respondent Employer had no meaningful alternative to its compliance with the demand of Respondent Union to discharge Lucero. The union was indisputably correct about the original violation and Respondent Employer was duty bound to rectify the situation. If it ignored the union's demand, it would compound the wrong. National labor policy favors the peaceful resolution of disputes pursuant to the provisions of collective bargaining agreements which have resulted from good faith bargaining among the parties. Respondents as parties to such a collective bargaining agreement should not be penalized financially if Respondent Employer has voluntarily undertaken to rectify a violation of such a contract. The Board itself has conceded that Respondent's conduct from the record presented to it does not reveal an attitude of general opposition to the purposes of the Act and accordingly, the Board has ordered only that Respondent cease and desist from engaging in the violations found in the particular case. We submit that such a cease and desist order without the necessity of penalizing Respondent with a reinstatement and back-

pay order will appropriately remedy the violations and accomplish the purposes of the Act. The balance of the order is penal and would force Respondents to perpetuate a conceded violation of the lawful contract.

For the foregoing reasons the provisions of the Boards order requiring reinstatement and back-pay should not be enforced.

Respectfully submitted,

DILLAVOU & COX,

C. C. DILLAVOU,

GEORGE M. COX,

By GEORGE M. COX,

*Attorneys for Respondent Sully-Miller
Contracting Company.*

Certificate.

I certify that in connection with the preparation of this brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

GEORGE M. COX

No. 20584

IN THE

United States Court of Appeals
FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

SULLY-MILLER CONTRACTING COMPANY, and CON-
STRUCTION TEAMSTERS UNION, LOCAL 606,

Respondents.

**BRIEF FOR RESPONDENT CONSTRUCTION
TEAMSTERS UNION, LOCAL 606.**

BRUNDAGE & HACKLER,

CHARLES K. HACKLER,

JULIUS REICH,

1621 West 9th Street,
Los Angeles, Calif. 90015,

*Attorneys for Respondent, Construction
Teamsters Union, Local 606.*

FILED
APR 10 1956
WILLIAM L. LUCK, CLERK

TOPICAL INDEX

	Page
Statement of facts	1
Argument	2
1. Introduction	2
2. The concept of "waiver" is not applicable to the present case	3
Conclusion	6

TABLE OF AUTHORITIES CITED

Case

Miranda Fuel Co., 140 N.L.R.B. 181 enf. den., NLRB v. Miranda Fuel Co., 326 F.2d 172	4
---	---

No. 20584

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

SULLY-MILLER CONTRACTING COMPANY, and CON-
STRUCTION TEAMSTERS UNION, LOCAL 606,

Respondents.

BRIEF FOR RESPONDENT CONSTRUCTION TEAMSTERS UNION, LOCAL 606.

STATEMENT OF FACTS.

The Respondent Construction Teamsters Union Local No. 606 (herein called "the Union") and the respondent Sully-Miller Contracting Company (herein called "the Employer"), were party to a collective bargaining agreement [G.C. 2] which required the Employer to utilize the Union's open and non-discriminatory hiring hall as its exclusive source of workmen [Tr. 17; R. 33-34]. Valentin Lucero, the charging party, was admittedly neither hired through the hall [Tr. 25; R. 42] nor a member of the Union [R. 42]; and his discharge was procured by the Union.

Although there exists testimonial conflict as to the reason for Lucero's termination, for the purpose of this proceeding the Union accepts the Board's findings that his discharge was secured by the Union because of his lack of Union membership.

ARGUMENT.

1. Introduction.

The Union will limit itself to a showing that the remedy proposed by the Board is not only inappropriate and inequitable, but that it is impermissible under the Act. That remedy includes a requirement that the Union withdraw its opposition to the employment of Lucero, and make him whole [R. 29, Par. II., 2(a) and (b)].

The Union's contract with the Employer contained a provision requiring the Employer to use the Union's out-of-work list and dispatch system as the Employer's sole and exclusive source of workmen [G.C. 2, Art. II, B., 1 and 2; R. 33]. Lucero was not hired by the Employer in accordance with this requirement and was, therefore, on the job in violation of a valid provision of the parties' collective bargaining agreement. While the Union acknowledges that under the Board's findings Lucero's discharge was demanded for an improper reason, Lucero nonetheless had no right to retain that position, and he should not, therefore, be riveted into that job by a court order, ahead of others whose seniority entitles them to it.

For its argument, the Union relies upon the argument section of the brief its counsel filed in *NLRB v. Painters District Council No. 52*, Ninth Circuit, No. 20505, and pursuant to the stipulation entered into with the Board, the argument section of that brief is incorporated herein by reference. There remains, however, one point which is pressed by the Board in the present case and not covered in the other brief, and that is the Board's argument concerning an alleged "waiver."

2. The Concept of "Waiver" Is Not Applicable to the Present Case.

The present case involves employment in the construction industry, which is unlike employment in manufacturing or other industries. Construction work is intermittent and generally available on a job-to-job basis.¹ Between jobs an employer will lay off most, if not all of its employees. These workers then seek, through the Union's dispatch hall, similar employment with other companies.

The Union maintains various out-of-work lists for (a) workmen who, within the past five years have performed work in the industry and in the area, and (b) workmen who have not been so employed [G.C. 2, Art. II, para. B., §4(a), (b) and (c)]. Workmen are dispatched in the order their names appear on the various lists and those on the (b) list are not called until the (a) list has been exhausted. Thus, the available work is fairly distributed to workers on the basis of their service in the industry and the length of time they have been out of work.

The out-of-work lists serve the purpose of a seniority roster in a manufacturing plant, since those who have the greatest seniority in layoff, *i.e.*, those who have been out of work the longest, are the first ones dispatched to available employment in their respective grouping. The purpose behind requiring employers exclusively to use the dispatch hall rather than their own

¹See, *e.g.*, speech by Saul J. Jaffe, Associate Solicitor of the Board, reported in 45 L.R.R.M. 71 (1960): "Fluidity of employment in the building and construction industry and the short-term nature of construction projects make for the casual and occasional nature of construction employment."

sources of employment, is to provide an equal opportunity at available employment to all unemployed workers, based solely upon their relative seniority and the order in which they signified their availability for work.

The employer who hires outside of this referral system, and the worker who secures employment from such an employer, are not cheating the union which maintains the out-of-work list. They are discriminating against each of the hundreds of workmen who are part of the referral system and who are waiting, in order of seniority and availability, to be dispatched.

Applying these principles to the facts of the present case, it is obviously meaningless to say that the Union "waived" the Employer's violation of the dispatch rules, since the Union cannot lawfully make such a waiver. For example, in *Miranda Fuel Co.*, 140 N.L.R.B. 181 (1962), *enforcement denied*, *NLRB v. Miranda Fuel Co.*, 326 F.2d 172 (2d Cir. 1962), the Board held that it was unlawful for a union to control the seniority rights of employees in an arbitrary manner, which would be the case here if the Union could be said to have "permitted" Lucero to get in line ahead of all the other workers on the out-of-work list. "Waiver" of the contract requirement that Lucero take his place on the out-of-work list would itself constitute a violation of the National Labor Relations Act, and would be discriminatory of Lucero's fellow workers. See *Miranda Fuel Co.*, *supra*.

The “Waiver” argument should not be considered for another reason, because it primarily relates to conduct of the Union’s predecessor, Local 692, and in this regard, the Union made timely objections to the introduction of such evidence on the ground that it went beyond the pleadings since only the Union and not Local 692 was a respondent [Tr. 11, lines 10-18], and on the further ground that it was hearsay and not admissible because it related to persons not party to the Board’s proceeding (and thus would not constitute an admission) [Tr. 12, lines 9-14].

Should the Board’s order requiring the Union to withdraw its objection to the employment of Lucero be enforced, it would result in Lucero gaining super-seniority at the expense of his fellow workers. Is Lucero, who cheated his fellow workers out of employment by circumventing the out-of-work list, now to be made whole as though he had lawfully acquired the job which he in fact secured in violation of contractual commitments? This would constitute a reward for duplicity.

It is enough of a remedy in this case to enforce the Board’s order exclusive of the objected-to portions. To make Lucero whole for earnings to which he was not entitled in the first place is impermissible and inequitable. It would not further the policies of the Act.

CONCLUSION.

For the foregoing reasons, and for the reasons set forth in the respondent's brief in case no. 20505, paragraph II, 2(a) and (b) of the Board's order should not be enforced.

Respectfully submitted,

BRUNDAGE & HACKLER,
CHARLES K. HACKLER,
JULIUS REICH,

By JULIUS REICH,
*Attorneys for Respondent, Construction
Teamsters Union, Local 606.*

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIUS REICH

No. 20667 ✓

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ESS H. NICHOLAS, JR.,

Appellant

-vs-

SECRETARY OF THE DEPARTMENT OF
INTERIOR, AND THE
UNITED STATES OF AMERICA

Apellee.

BRIEF OF APPELLANT

FISHER & HORNADAY
Box 397
Kenai, Alaska

Attorneys for Appellant

FILED
AUG 8 1966
WM. B. LUCK, CLERK

I N D E X

	<u>Page</u>
I. Statement of Jurisdiction	1
II. Questions Presented	3
III. Specification of Errors	4
IV. Statement of the Case	5-9
V. Summary of Argument	10-12
VI. Argument	13-37
A. The Court erred in relying on the administrative decision as having a rational basis . .	13
B. The trial court erred in not permitting the administrative record to be amplified . .	16
C. The Court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant . .	17
D. The Court erred by not granting Appellant's prayer for equitable relief . .	33
VII. Certificate	38

CITATIONS

CASES:

Page

<u>Bowen v. Hickey</u> , 200 Pac. 46 (Cal. 1921), <u>cert. denied</u> , 257 U.S. 656, 66 L.ed. 420	. . 20
<u>Consolidated Edison Co. v. NLRB</u> , 305 U.S. 197, 229, 59, S. Ct 206, 217, 83 L.ed. 126 (1938)	. . 17
<u>Great Northern R. Co. v. Reed</u> , 270 U.S. 539, 456-7, 70 L.ed. 721, 725 (1926)	. . 14, 16, 21, 33, 36
<u>Hillstrand v. State</u> , 395 P. 2d 74, 77 (Alaska 1964)	. . 16, 21
<u>Moser v. United States</u> , 341 U.S. 41, 71 S. Ct. 553, 95 L.ed. 729 (1951)	. . 16, 21
<u>Oregon & C.R. Co. v. United States</u> , 189 U.S. 102 47 L.ed. 726 (1902)	. . 22
<u>St. Paul M & M R. Co. v. Donahue</u> , 210 U.S. 21, 38, 52 L.ed. 941, 946 (1907)	. . 14, 33
<u>Stewart v. Penny</u> , 238 F. Supp. 821, 831 (D Nev. 1965)	. . 14, 17, 25, 29, 30,
<u>Tarpey v. Madsen</u> , 178 U. U.S. 215, 220, 44 L.ed. 1042, 1044 (1899)	. . 14
<u>United States v. Macdaniel</u> , 32 U.S. (7 Pet.) 1, 14, 15, 8 L.ed. 527 (1833)	. . 20
<u>United States v. Mills</u> , 190 F. 2d 513, 521 (5th Cir. 1911)	. . 14, 33
<u>United States v. Richards</u> , 149 Fed. 443, 450 (D. Neb. 1906), <u>Cert. denied</u> , 218 U.S. 670, 54 L.ed. 1203	. . 36
<u>Whaley v. Northern Pac. R. Co.</u> , 167 Fed. 664, 670 (D. Mont. 1908)	. . 36

LAND DECISIONS:

Page

<u>Charles L. Hofwalt</u> , 9 L.D. 1 (1889)	. . 23
<u>Findley v. Ford</u> , 11 Land Dec. 173	. . 22
<u>Hclman v. Hickerson</u> , 17 Land Dec. 200	. . 23
<u>John E. Tyrl</u> , 3 L.D. 49 (1884)	. . 14,22
<u>Knoble v. Orr</u> , 27 L.D. 61 (1898)	. . 16,21
<u>Massey v. Malachi</u> , 11 L.D. 191 (1890)	. . 36

MISCELLANEOUS:

4 Davis Administrative Law §§ 30.12-14	. . 13
43 U. S. C. A. § 164	. . 16
Webster's Third International Dictionary	. . 13
Hearings before the Subcommittee on Public Lands of the Committee on Interior and Insular Affairs, United States Senate, S-758 (May 7 & 7, 1963)	. . 34,35,37

IN THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 20667

JESS H. NICHOLAS, JR., Appellant,

vs.

SECRETARY OF THE DEPARTMENT OF INTERIOR, AND THE
UNITED STATES OF AMERICA, Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

STATEMENT OF JURISDICTION

The Appellant, pursuant to Rule 73, Federal Rules of Civil Procedure, and Rule 18(b) of the Rules of the United States Court of Appeals for the Ninth Circuit, files this statement of the basis on which the United States Court of Appeals for the Ninth Circuit has jurisdiction in this case.

The case was heard in the Federal District Court on an appeal from a decision of the Secretary of the Department of the Interior, affirming a Decision of the Bureau of Land Management, Division of Appeals, rejecting appellant's offer of final proof for issuance of a homestead patent to 5 U.S.C. §1009, Administrative Procedure Act. The Bureau of Land Management,

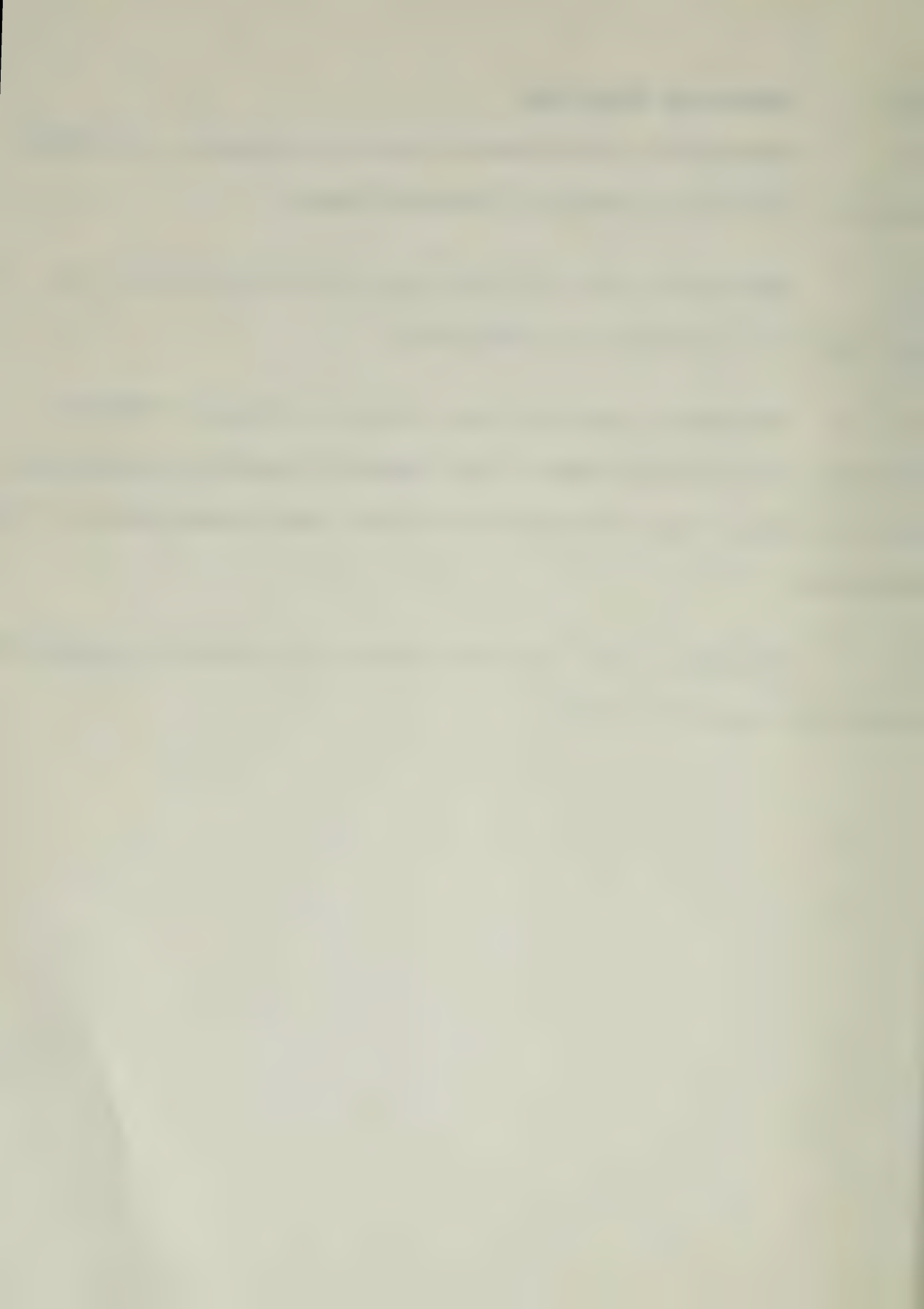
Division of Appeals affirmed the decision of the Bureau of Land Management Land Office.

Jurisdiction in this case is founded on the existence of a Federal question and the amount in controversy. The action arises out of the homestead laws of the United States including but not limited to revised Statute §2291(1875), as amended, 43 U.S.C.A. §164 (1958). The matter in controversy exceeds, exclusive of interest and costs, the sum of \$10,000.00.

The jurisdiction of the court is not at issue in this case. The Division of the Federal District Court was a final decision and appears in the Record at pages 85-86. Appeal to the Court of Appeals is made pursuant to 28 U.S.C.A §1291.

II. QUESTIONS PRESENTED

- A. Whether or not the Court erred in relying on the administrative decision as having a "rational basis."
- B. Whether or not the Court erred in not permitting the administrative record to be amplified.
- C. Whether or not the Court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant.
- D. Whether or not the Court erred by not granting Appellant's prayer for equitable relief.



III. SPECIFICATION OF ERRORS

- A. The Court erred in relying on the administrative decision as a "rational basis."
- B. The Court erred in not permitting the administrative record to be amplified.
- C. The Court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant.
- D. The Court erred by not granting Appellant's prayer for equitable relief.

IV.

STATEMENT OF THE CASE

Jess H. Nicholas, Jr.'s (appellant) homestead entry for the South 1/2 South 1/2, Sec. 26, Township 3 North, Range 12 West, Seward Meridian, Alaska, was allowed on August 3, 1956. Appellant filed final proof on July 20, 1961, stating the following: He was a native born citizen of the United States; he was married and the father of two children; he was the person who made homestead entry on the above premises; the residence claimed was made upon the original entry; actual residence was established August 10, 1956; he established a habitable house on the land; the house became habitable on August 10, 1956. The periods of actual residence on the land were stated to be:

Residence Year	Appellant's Residence From	To	Family Residence From	To
1956	Aug 10, 1956	Aug 1, 1957	Aug 10, 1956	Nov 20, 1957
1957	Oct 30, 1957	Nov 20, 1957		
1958	Mar 25, 1958	Feb 28, 1960	Mar 28, 1958	Feb 28, 1960

Periods of absence from the land and reasons given included:

Residence Year

1957	Aug 1, 1957	Oct 30, 1957	Claimant	Working Aleutian Islands
1957	Nov 20, 1957	Mar 25, 1958	Both	Vacation in various states

Actual agricultural use of the land was stated to be:

Year	Crop	Acres Cultivated	Grazing Use	Reason for Cultivating Less Acreage than required by law
1957	Alaska Timothy	3 (not harvested)	None	Unable to find someone to clear land
1958	Rye	10 "	None	"
1961	Rye	7 "	None	"

The list of improvements placed on the lands in the homestead included:

Description	Year Made	Value of Materials	Value of Labor	Total Value
16' x 20' cabin	1956	\$2200.00	\$500.00	\$2700.00
7' x 14' porch on cabin	1957	400.00	50.00	450.00
26' x 30' concrete basement	1958	1000.00	400.00	1400.00
Gravel road built	1958		560.00	560.00

The present value of the improvements was given as \$6000.00.

Appellant further stated that the land was not within the limits of an incorporated town or selected site of a city or town; the homestead was not used for trade or business, there were no indications of minerals; he had not sold conveyed, agreed to sell or convey, or optioned, mortgaged, or agreed to option or mortgage the land, or any part of it; he had not made another homestead entry, or any other entry; and that he had not

heretofore perfected or abandoned an entry made under the homestead laws of the United States (R 14-16).

The final proof offered by the appellant was rejected on the basis that appellant failed to cultivate one-eighth of the area of the entry during the third and fourth years of the entry, as required by 43 U.S.C.A §164.

In his appeal to the Bureau of Land Management, Division of Appeals, appellant explained that the land office had informed him that cultivation of the land was not required during the first three years as all of the clearing was done during those years. In spite of this explanation, the Division of Appeals held that the cultivation requirement was mandatory and could not be excused by Bureau of Land Management employees.

On appeal to the Secretary of the Department of the Interior, appellant further explained that the three acres planted in 1957 and the ten acres planted in 1958 were planted in perennial grasses which did not require cultivation. He repeated his explanation that if he failed to meet the cultivation requirements, it was because of misleading information received from Bureau employees. He requested that he at least be awarded a homestead of 104 acres, based upon the cultivation of 13 acres. Although the assistant solicitor who



wrote the decision for the Secretary of the Interior conceded that the Department has not laid down a fixed rule as to what constitutes cultivation, the solicitor held that appellant's cultivation was not sufficient.

The appellant explained that it has been Bureau policy in the area in question not to require cultivation every year until application is made for patent and, further, that the Bureau has waived cultivation requirements in other applications for patent. The decision of the Secretary by the assistant solicitor held that cultivation requirements are mandatory and no departure therefrom is permissible (R 47).

Pursuant to 5 U.S.C.A. §1000-11, Administrative Procedure Act, the Alaska Federal District Court granted judicial review of the Decision of the Secretary of the Department of the Interior (R 35). The District Court handled the matter as a motion for summary judgment (R 36). Appellant repeated his former testimony before the District Court. He testified that he cleared and cultivated 20 acres of the land in question (R 78). He also testified that among other efforts, he and his wife had pulled a 12 ft. log, weighing over 100 pounds back and forth over the land by hand in an effort to prevent erosion. In spite of the appellant's un rebutted testimony, the Alaska Federal District Court, in a

one page decision, granted summary judgment for defendant, Secretary of the Department of the Interior.

"The court now finds that the construction of the law in connection with the administrative decision complained of has a rational basis and that the findings of fact are supported by substantial evidence on the record as a whole. The Court therefore concludes that defendant is entitled to summary judgment as a matter of law." (R 85)

V. SUMMARY OF ARGUMENT

A. The Court erred in relying on the administrative decision as having a rational basis.

It is not sufficient that an administrative decision which construes the law, has a "rational basis" to sustain it on appeal. If only a "rational basis" were required, there would be no uniformity whatsoever in the interpretation of status and regulations. There are several rational approaches to the interpretation of statutes and regulations pertaining to homesteading. However, a decision must have more than a "rational basis" to provide guidelines for both homesteaders and agency employees.

The decision of the Secretary did not have a rational basis in that the Secretary applied regulations and instructions which were not in effect at the time Appellant was proving up on his patent. Also, the Secretary utilized regulations which were not applicable to Alaska.

In his decision, the Secretary admitted that there is no fixed standard as to what constitutes cultivation. Nevertheless, the Secretary applied a stringent rule of cultivation which was not in effect at the time of Appellant's effort.

The Land Office denied Appellant's final proof on the basis that Appellant did not cultivate one-eighth of the acreage during the third and fourth years of the entry. However, the

Division of Appeals inserted the argument that Appellant's method of planting was insufficient.

B. The trial court erred in not permitting the administrative records to be amplified.

C. The Court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant.

The decision of the Secretary was not based on substantial evidence. As stated above, the various appeal levels of the Department of the Interior switched position in refusing to issue patent. Retroactive and inappropriate regulations were applied. The course of conduct of the Department has been liberal in favor of homesteaders. Appellant was misled by statements of employees of the Department of the Interior and did not cultivate one-eighth of the land during the third and fourth years of the entry because of his inability to obtain a tractor. Therefore, the Secretary is estopped to deny the issuance of the patent.

Contrary to the Secretary's position, there is sufficient elasticity under the appropriate statutes to issue patent. Cultivation requirements have not been strictly enforced by the Department in other instances.

D. The Court erred by not granting plaintiff's (Appellant's)

prayer for equitable relief.

Homesteaders are entitled to preferred treatment and protection under the Homestead statutes. In the instant case, rather than being given preferred treatment, Appellant was mistreated. As stated above, Appellant relied on statements by Department employees. In place of giving Appellant the preferred treatment to which he is entitled, the Department switched positions and utilized inappropriate regulations and instructions and attempted to apply them retroactively. Further, although the Department concedes there is no standard of "cultivation", a rigid, retroactive and inappropriate standard for cultivation was applied to the Appellant. The reprehensible conduct of the Department of the Interior in this and other cases has led to a public distrust of the Department with a resulting lag in the enjoyment by individuals of the blessings of the American dream through the utilization of federal programs. Actions such as those utilized by the Department of the Interior in this case have been condemned not only by courts but by congressional committees as well.

The appellant has fought through three levels of administrative procedures and two levels of judicial appeal over a period of five years. He has shown that he is at the very least, entitled to equitable relief in the form of a patent with subsurface rights to 104 acres of the land in controversy.

VI. ARGUMENT

A. The court erred in relying on the administrative Decision as having a rational basis.

An administrative decision should have more than a "rational basis". There may be several rational approaches to the interpretation of statutes and regulations. A decision must have more than a "rational basis" if it is to provide guidelines for homesteaders and agency employees.

The phrase "rational basis" is merely a verbal formula. Its inconsistent application has confused a leading authority in the field of administrative law. See discussion of "rational basis" in 4 Davis Administrative Law §§ 30.12-14.

Close analysis of the ways of the Supreme Court in reviewing administrative action yields the rather clear conclusion that the scope of review in any particular case depends much more upon the various factors that guide the exercise of judicial discretion than it does upon judicial fidelity to any verbal formula. Ibid. at page 270.

Even if the "rational basis" test is applied, the decision of the Secretary will not stand. "Rational" is defined as "agreeable to reason: Intelligent, sensible." Webster's Third New International Dictionary.

The decision of the Secretary does not qualify under the above definition. Although the Secretary conceded that there is no standard of cultivation, the Secretary insisted upon a strict appli-

cation of this non-standard. (R 6). Not only is the strict application of a non-standard not "agreeable to reason," it is contrary to the mandate of the United States Supreme Court that homesteaders are entitled to a liberal interpretation of the homestead requirements. Great Northern R. Co. v. Reed, 270 U.S. 537, 456-7, 70 L.ed. 721, 725 (1926); St. Paul M & M R. Co. v. Donahue, 210 U.S. 21, 33, 52 L.ed. 941, 946 (1907); Tarpey v. Madsen, 178 U.S. 215, 220, 44 L.ed. 1042, 1044 (1899). See also United States V. Mills, 190 F. 2d 513, 521 (5th Cir. 1911) and Stewart v. Penney, 238 F. Supp. 821, 831 (D. Nev. 1965).

Appellant cleared and cultivated 20 acres, as required under 43 U.S.C.A. §164. He and his family resided on the land from 1956 - 1961. Appellant constructed a cabin, a porch to the cabin, a concrete basement, and a gravel road. (14-16). Appellant carefully followed the instructions of the Soil Conservation Service in utilizing procedures to prevent soil erosion. Appellant and his wife even went to the extent of dragging a log by hand over the property to prevent erosion. (R 22-24).

The Secretary has issued patent, in previous instances, where the entryman only cleared one half acre. John E. Tyrl, 3. L.D. 49 (1884). (See also C. below for a comprehensive discussion of "liberal" Land Decisions.) Therefore, it is not only irrational, it is unfair to apply a strict standard of cultivation to Appellant.

Surely, a 1956 homesteader on the Kenai Peninsula in Alaska, is entitled to as much consideration as a 19th century homesteader.

As further evidence of the irrationality of the Secretary's decision, the Secretary relied on requirements that were not in effect at the time Appellant was proving-up (R 4-6). The Secretary also utilized regulations which were not applicable to Alaska.

Moreover, Appellant was subjected to a switch in position by the Department. The Land Office denied Appellant's final proof on the basis that he did not cultivate a sufficient number of acres. The Division of Appeals held that the processes of cultivation utilized by Appellant were not sufficient. (R4-7).

Appellant planted three acres of timothy, a perennial grass, in 1957 and ten additional acres to rye in 1958, also a perennial grass. (R14-16). Land Office employees had informed Appellant that clearing alone was sufficient during the first three entry years. (R 4). However, when Appellant found it impossible to find a tractor in 1959, he made a difficult journey to Anchorage to make certain he was complying with the requirements. The Land Office was full of people involved in oil leases. When he finally reached the counter, he was told by a Department employee that an exception on the cultivation could be granted at the time of final proof in cases of undue hardship or where it was impossible to perform as required. (R 23-4). Appellant relied on this informa-

tion and rented a tractor as soon as one was available and disked and sowed the last seven acres. (R 23-4) Also the Secretary, historically has been liberal in interpreting homestead requirements (See C. below). Accordingly, it is the position of the Appellant that the Secretary is estopped from relying on a strict interpretation of the cultivation requirements of 43 U.S.C.A.

§164. Moser v. United States, 341 U.S. 41, 71 S. Ct. 553, 95 L.ed. 729 (1951); Great Northern R. Co. v. Reed, 270 U.S. 539, 546-7, 70 L.ed. 721, 725 (1926); Hillstrand v. State, 395 P.2d 74, 77 (Alaska 1964); Knoble v. Orr, 27 L.D. 61 (1898).

B. The trial court erred in not permitting the administrative record to be amplified.

The trial should have permitted the Appellant to amplify the administrative record.

C. The court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the appellant.

In order to sustain an agency decision on appeal, the agency must show that the decision was based upon "substantial evidence". Consolidated Edison Co. v. NLRB, 305 U.S. 197, 229, 59 S. Ct 206, 217, 83 L.ed. 126 (1938). The decisions of the Secretary are entitled to respect, but, as in this case, the decision

...must be set aside when the record . . . clearly precludes the decision from being justified by a fair estimate of the worth of the testimony of witnesses or its informed judgment on matters within its special competence or both. Universal Camera Corp. v NLRB, 340 U.S. 474, 71 S. Ct 45, 95 L. ed. 456, 468-9 (1951)

Fortunately, we are not without guidance in regards to judicial review of decisions of the Secretary of the Interior which refuse to issue a patent. In a 1965 case, Stewart v. Penny, 238 F. Supp. 821 (D. Nevada 1965), which is very similar to the instant case, the land examiners of Bureau of Land Management initiated adverse proceedings^{to}/the issuance of patent. The hearing examiner dismissed the adverse proceedings. The Director of the Bureau of Land Management reversed the examiner. The Assistant Solicitor, acting for the Secretary of the Department

of the Interior affirmed the Director. The District Court of Nevada reversed the Secretary and ordered that patent issue. In regards to judicial review under the Administrative Procedure Act, the court said:

We recognize the peculiar and specialized knowledge of the officers of the Department of the Interior respecting the interpretation of the multifarious laws and regulations relating to public lands, and that Congress has entrusted the guardianship of the public domain to the Department of the Interior. . . . we cannot, however, accept without limitations, a contention that a high administrative official in Washington, D. C. is better qualified than others to analyze and draw conclusions from a cold record produced at an evidentiary hearing three thousand miles away and relating the physical conditions with which he has questionable familiarity, conditions normally deemed to be within the realm of judicial notice. We deem the correct rule of judicial review to be that enounced in Foster v. Seaton, 1959, 106 U.S. App. D.C. 253, 271 F.2d 836: "Thus the case really comes down to a question whether the Secretary's finding was supported by substantial evidence in the record as a whole."

The omnipotence of the Department of the Interior as guardian of the public domain is exhibited when the Department acts affirmatively and grants patents under the public land laws. The converse is not true. An entry or application for patent which is contested or rejected by the Secretary presents issues regarding the legal rights of the entryman under the public land laws. These are rights established by Congress which the Secretary of the Interior may not arbitrarily or capriciously ignore and which must be determined within the due process safeguards of the Administrative Procedure Act. Page 827 (Emphasis supplied).

The Stewart case is peculiarly applicable, not only because it reversed a decision of the Secretary of the Interior

Department on the issuance of a patent to a homestead. The court's statements on the homestead procedures read like a page out of an Alaska homesteader's diary.

The inadequacy of our public land laws to afford reasonable workable methods, under present conditions, for the acquisition of public lands by private citizens is a matter of growing national concern. It is of particular concern to the State of Nevada inasmuch as approximately eighty-five percent of the area of this State (the seventh largest) is still in the public domain. Much of it has a valuable potential for private use. Yet the archaic federal land laws, enacted in an era of an agrarian economy, are ill-suited to an orderly disposition of the lands into private ownership. The laws were enacted with the laudable motive of enabling the penniless pioneer to acquire a home for himself and family primarily through toil and with little capital expenditure. That purpose was long ago achieved and most of the lands of the Western States which had a valuable agricultural potential, even if only marginally so, have been patented to individuals under the beneficent laws to the exclusion of the wealthy who, under a different policy, might have acquired large blocks of public lands by purchase. The inapplicability of the policy to modern conditions has, during the past quarter-century, accomplished a virtual deep-freeze of public lands in federal ownership.

Page 822-3.

The Land Office denied appellant's final proof on the ground that Appellant did not cultivate sufficient acreage (R 47). The Division of Appeals inserted the position that Appellant's method of planting on the twenty acres was not "cultivation." (R 47). Thus, appellant has been required to attempt to answer what he thought was the position of the Bureau, only to be surprised at a higher appellate level with another argument.

The Secretary relied upon Regulations and Land Decisions involving cultivation requirements which were not in effect at the time appellant was proving up (R 5-6). Therefore, these authorities are inappropriate as a basis upon which to base an agency decision. United States v. Macdaniel, 32 U.S. (7 Pet.) 1, 14, 15, 8 L.ed. 527 (1833); Bowen v. Hickey, 200 Pac. 46 (Cal. 1921), cert. denied, 257 U.S. 656, 66 L.ed. 420. It is certainly less than fair to expect a homesteader on the Kenai Peninsula in Alaska, in 1956, to comply with non-existent requirements.

Appellant explained that he was informed by land office ^{that} employees/clearing was sufficient during the first three entry years. (R 4). Further, appellant testified that when, in 1959, he discovered he could not obtain a tractor, he travelled to Anchorage to explain the situation to the land office. The office was full of people involved in oil leases. After waiting a considerable length of time, he was told by a land office employee that an exception on the cultivation could be granted at the time of final proof. Relying on this information, appellant rented a tractor as soon as one was available and disked and sowed the last seven acres to rye. (R 23-4). In spite of the above, the Secretary, although the decision is not clear on this point, continues to rely on the position that the number of acres cultivated was not sufficient. (R 5). Further, appellant's testimony stands unrebutted

that it is the policy of the Bureau in the land area in question not to require cultivation until application is made for patent and that the Bureau has waived cultivation requirements on other patent applications. It is the position of the appellant that by reason of appellant's reasonable reliance on the information and suggestions of Department employees and the course of conduct of the Department, the Secretary is estopped from relying on and may not rely on a strict interpretation of the cultivation requirements of 43 U.S.C.A. § 164. Moser v. United States, 341 U.S. 41, 71 S.Ct. 553, 95 L.ed. 729 (1951). A homesteader should not suffer because of the actions of the Land Office. Great Northern R. Co. v. Reed, 270 U.S. 539, 546-7, 70 L.ed. 721, 725 (1926); Hillstrand v. State, 395 P.2d 74, 77 (Alaska 1964); Knoble v. Orr, 27 L.D. 61 (1898).

In his decision, the Secretary admitted that there is no fixed standard as to what constitutes cultivation for homesteading. Nevertheless, the Secretary applied inappropriate and retroactive authorities to find that the planting of timothy and rye was not "cultivation." Further the Secretary reasoned that even though there is no standard for cultivation, the non-standard must be strictly enforced and no departure therefrom is permitted. (R 6).

Not only the logic of the Secretary is subject to question. A close study of the Land Decisions and other authorities indicates that Appellant's efforts were clearly sufficient. The law only

requires substantial compliance, not absolute compliance. 42 Am. Jur. Public Lands § 22, p. 801. In Oregon & C.R. Co. v. United States, 189 U.S. 102 47 L.ed. 726 (1902) the Supreme Court held in favor of individuals where:

Each person made his settlement with the intention of making a homestead entry of the lands, whenever that could be done under the Acts Congress. After the date of settlement each settler continuously resided and made improvements upon his land in the way of a dwelling house, barn, outhouses, fencing, clearing, and planting of trees. Page 729. (Emphasis supplied).

In Findley v. Ford, 11 L.D. 172 (1890), the Secretary accepted Ford's proof over objections based on the following:

He testified that he had lived there continuously since making the filing; that he was an unmarried man, and had worked some for his neighbors, but slept at his house generally when so working; he had cleared and prepared for plowing some four acres of ground and had plowed about two acres; he had also prepared about one hundred fence posts preparatory to fencing his land. Page 173 (Emphasis supplied).

In John E. Tyrl, 3 L.D. 49 (1884), the Secretary reversed the cancellation of an entry.

The proof also shows that Tyrl has cleared "about one half acre" of said land, but has cultivated no portion of it nor raised any crop thereon.

The reason given by Tyrl for non-cultivation is that he settled too late.

It is not denied by the counsel for the appellant that the commutation proof required by said Section 2301 must show some cultivation by the entryman. It is, however, insisted that, in this case, the clearing of about one half acre, taken in connection with the time of settlement, and the

other proof offered, is a sufficient compliance with the requirement of said section.

Cultivation, as defined by Webster, is "the art or practice of cultivating; improvement for agricultural purposes; tillage; production by tillage".

It is clear that the kind of labor, as well as the amount required to prepare agricultural land for tillage, will depend upon the character of the land sought to be cultivated.

The clearing of the land covered with timber is as essential to successful cultivation of the soil as is the actual planting of the seed.

The real question at issue is the good faith of the entryman. Page 49 (Emphasis supplied).

Likewise, in Charles L. Hofwalt, 9 L.D. 1 (1889), the Secretary held that the following proof was sufficient:

The proof shows that Hofwalt was a single man and that his improvements consisted of a frame house eight by ten feet, a well and five acres of breaking -- total value \$45.00. His residence from February 27, 1882, to April 9, 1883, the date of final proof, was continuous.

Although the improvements are somewhat meagre they are not inconsistent with good faith, which is the fundamental principle upon which the right of pre-emption exists. Page 2 (Emphasis supplied).

In Holman v. Hickerson, 17 L.D. 200 (1893), the Secretary upheld the proof of a woman entryman with language indicating that requirements are not strictly enforced.

The remaining questions in the case relate to the character of her residence and improvements on the land, and whether or not they show good faith on her part.

In determining these questions, the degree and condition

in life of the entryman may properly be taken in consideration.....

She testified that in December, 1888, she put one acre in potatoes and turnips and other vegetables, and that in December, 1889, she plowed and raised five acres of wheat. She paid for the work by work of her own, as she had no means except what she had earned.

After an examination of the evidence, I am of the opinion that she had an honest intention to comply with the law, and that her improvements were commensurate with her means.
Page 202 (Emphasis supplied)

In contrast to the minimum efforts approved by the Secret above, Appellant's final proof showed that three acres had been planted in timothy and seventeen acres in rye. Appellant built a 16' by 20' cabin; a 7' by 14' porch; a 26' by 30' concrete basement and gravel road (R 14-16). Appellant testified:

We moved on the homestead in August, 1956, and in September 1956, we had three acres of land cleared. In June of 1957 I rented a tractor, plowed and disked the three acres. Upon completion of the above, it became apparent that summer or fall clearing was not the proper time to clear land as it took most of the moss off and left the soil subject to wind and water erosion. Immediately after we completed the disking, we sowed it with alsike clover and timothy, neither of which are an annual crop, as they both come back year after year and afford good protection against wind and water erosion. Neither of these are native to Alaska and therefore cannot be considered as native grasses. After sowing this three acres, my wife and I got a log approximately twelve feet in length and eight inches in diameter, weighing over 100 pounds and attached a rope to both ends. We then pulled this by hand over the entire three acres in an effort to pack the top soil and to prevent erosion. This crop has continued to grow each year, with the exception of the last two years when most of it was killed due to a lack of snow covering and severe icing. Every fall a group of horses have been

loose in the area and have heavily grazed on all my fields

Having been advised by the Soil Conservation Service that the best time to clear Alaskan land was in the early spring before the thaw occurred, I hired Mr. Morris Coursen to clear ten acres. In June, after he had cleared this land, I again was able to rent a tractor and, again upon the advice of the Soil Conservation Service, instead of plowing the land, I had it disked. This disking had an effect of mixing a small amount of top soil with what moss was left. This was the condition that had been recommended by the Soil Conservation Service people to prevent erosion of the land. We then planted it heavily with Rye Grass, again not a native grass of Alaska. This also was grazed upon by several horses running loose. (R 22-3) (Emphasis supplied). (The cultivation of the remaining seven acres has been explained above.)

The Final Proof and the above un rebutted testimony of Appellant clearly invalidates the contention of the Secretary that there was not a bona fide compliance with the law. The position of the Secretary that these efforts "were no more than a token compliance" (R 6) is not only without foundation, it is insulting. Homesteading in Alaska, where the climate varies from the upper 70s with mosquitoes to minus 40 below, is no easy task, as indicated by the proof and testimony of appellant.

Determination of what is satisfactory cultivation for the issuance of a homestead patent is not within the peculiar competence of the Department of the Interior and is subject to judicial review. In the 1965 case of Stewart v. Penny, 238 F. Supp, 821 (D. Nev. 1965), the court specifically set aside the Secretary's determination that cultivation was not sufficient, both as to number of acres

planted and as to method--the two basic issues in the instant case. Accordingly, the court's language is set forth at length.

Acreage Cultivated

On the issue of acreage cultivated, the Hearing Examiner stated that he could not find that 20 acres were cultivated as alleged by contestee Stewart, but that "neither can I find that less than one-eighth of the entry (15 acres) was cultivated as alleged by contestant." The Examiner then volunteered the opinion that the burden of proof was on the government. We do not agree. The Administrative Procedure Act imposes the burden of proof on "the proponent of a rule or order." (5 U.S.C. § 1006 [c]7. In our case, Stewart's Homestead Entry Final Proof, filed January 4, 1959, was an application for patent. Procedurally, the Contest Complaint filed by the Department was, in effect, an Answer to the Final Proof affirmatively specifying the alleged deficiencies. Procedure by way of a Contest Complaint is justified because the Final Proof is not in the form of a pleading and does not lend itself readily to a definition of issues by answer thereto. The procedural regulations then in effect (43 C.F.R. 221.7 1961 Regulations) provided that on hearing of a government contest, the contestant would first present his case. It does not follow therefrom that the burden of proof is on the government. The correct rule is stated in *Foster v. Seaton*, 1959 106 U.S. App. D.C. 253, 271 F.2d 836, involving a mining claimant. The reasoning there expressed is equally applicable to a homestead entryman. The true proponent of the rule or order is the applicant for patent or other right to public lands claiming compliance with the public land laws. The government "bears only the burden of going forward with sufficient evidence to establish a prima facie case and the burden then shifts to the claimant to show by a preponderance of the evidence that his claim is valid."

The Director, in his decision, interpreted the Examiner's finding with respect to the acreage cultivated as a finding that in excess of fifteen acres had been "cleared." This court considers it a finding, negatively expressed, that fifteen acres had been cultivated.

The Secretary deliberately restricted his reasons for affirming the cancellation of the entry to the findings: "the entryman did not apply the process of cultivation which he employed to the required 1/8 of the entry." (Italics added). This is the finding of the final agency authority which is subject to judicial review. If arbitrary and unsupported by substantial evidence and not in accordance with law, the decision based on the finding should be reversed.

The finding is based upon a very thorough and careful analysis of the testimony and surely is not arbitrary in the sense of being capriciously made without due consideration of the evidence. The finding, nevertheless, in our opinion, is unsupported by the evidence and was made without regards for the principle that the homestead laws should be liberally interpreted in favor of the entryman.

Most of the state of Nevada is rough, hard, dry country. Water is in short supply. The reclamation of this land for agricultural use is not easy, and the area here in question is of the kind described. The "process of cultivation" which this entryman applied were suitable to the homestead. He intensively cultivated from one to two acres near his house, growing corn, potatoes, strawberries, sweet potatoes, peanuts and onions. He brought water to the area by pipeline and plastic hose for the irrigation of the produce. He cleared an additional fourteen acres adjoining the garden plot and from one to three acres near the north boundary of the homestead. These areas he plowed, seeded to rye, harrowed and irrigated, by hose and sprinkler to the extent of his capacity and the resources available. On a portion of the land, he left windrows of sagebrush to stay erosion by prevailing winds, which were subsequently removed by bulldozer in 1958 and 1959.

The adequacy of the acreage involved in this activity is not open to substantial doubt. It was surveyed by a licensed civil engineer, a witness for Stewart, who surveyed 15.2 acres of cleared land in the larger parcel and 3.1 acres in the smaller. A registered surveyor for the Bureau of Land Management surveyed and located the boundaries of the 120 acre homestead entry and prepared a map (Exhibit R) on which he accurately located the

reservoir, road, pipeline, well, houses, and other improvements on the property, and the elevations and contour line. The government surveyor did not testify. The map he prepared did not show the boundaries of the cleared area. These boundaries were superimposed thereon in pencil by a government land examiner who had used "pacing" method of estimating boundaries and distances and estimated 12.5 acres in the large cleared area and one acre in the smaller. The actual survey by a registered civil engineer must be given credence over an estimate of acreage based on pacing distances and boundaries.

Stewart testified by reference to an aerial photograph of the farm. It is true, as suggested by the Secretary, that there were some distortion of distances because of the perspective. Nevertheless, the cleared areas are obvious on the photograph, and are, by comparison, the same cleared acres surveyed by Stewart's surveyor. Stewart, by reference to the photograph, showed that he had cultivated and planted rye on over half the cleared area in 1956 and planted rye on the whole cleared area in 1957 and 1958. Mrs. Stewart testified that all the cleared area was in rye for three years. This testimony clearly supports a finding that the entryman did apply the processes of cultivation which he employed to the required one-eighth (15 acres) of the acreage of the entry.

The Secretary relied heavily upon the failures of other witnesses to testify positively to cultivation of the entire cleared acreage. In our view, their testimony strongly corroborates that of Mr. and Mrs. Stewart with respect to the employment of processes of cultivation on the homestead entry. It should not be expected they could testify to a specific number of acres, or that they saw a crop growing on the entire area. Their testimony is not inconsistent with Stewart's claim of having plowed, seeded and harrowed the whole field. On the contrary, the testimony corroborates his claim to the extent that the witnesses did see, observe and remember. The presence of brush windrows on a portion of the land, later removed, does not detract from the cultivated area. Such windrows may be considered an aid to cultivation and were one of the processes of cultivation employed by the entryman. The careful analysis of the testimony made by the Secretary demonstrates that there is no substantial evidence to support a finding that the entryman did not

apply the processes of cultivation which were employed to one-eighth of the entry.

The fact Stewart's rye crop failed because of freezing, depredations by mice, rabbits and other rodents, and invasions of ranging livestock (the entry was unfenced) are irrelevant to this inquiry, except insofar as they account for the inability of some of the witnesses to see evidence of a rye crop at different times -- periods of observation.

Conclusion

We have related the administrative history of this case at some length. The varying approaches to decision adopted in the administrative hierarchy seem to us to stem from a basic feeling that the area was not properly classified for homestead entry. This may or may not be so. Perhaps it would have been more prudent to classify less than the entire 120 acres covered by the amended application as suitable for homestead entry. Once the entry was allowed, however, the entryman had to do what was necessary to comply with the statutory requirements to be entitled to patent. The photographs, maps and testimony prove that he did so, taking into consideration "the degree and condition in life" of the entryman and the obstacles of nature and environment with which he contended. Pages 831-33. (Emphasis supplied).

The effect of the Stewart case on the Secretary's decision in the instant case is devastating. Like the land in Nevada, the land on the Kenai Peninsula is difficult to homestead. The Secretary indicated that the planting of rye was not cultivation. (R 6) However, Stewart indicates that the planting of rye is sufficient cultivation for homestead purposes. Stewart v. Penny, supra, at page 832. The case also holds that prevention of erosion is one of the processes of cultivation. Ibid, at 832. Therefore, appellant's

efforts at preventing erosion on the land in question qualify as a process of cultivation. (R22-3). Noticeably absent from the opinion is the requirement of the Secretary (R 6) that a homesteader must establish a profitable agricultural operation.

Finally, and most important, Stewart sets to rest, hopefully, for good, the untenable contention of the Secretary that even though there is no standard of cultivation, this non-standard must be strictly applied. Stewart follows the overwhelming weight of authority that an entryman is entitled to a liberal interpretation of the requirements of homesteading and is not to be subjected to a narrow interpretation. Page 831. Rather than the ridiculous no variance approach of the Secretary, the court instructed that it should be determined whether the processes utilized were suitable to the land in question (page 831); the age and ability of the entryman were to be considered; and the obstacles of nature and environment with which the entryman contended were to be taken into consideration (page 833). The efforts of Appellant as set forth above, clearly qualify under the standards set up by the Stewart case.

The Land Decisions of the Secretary set forth, supra, are in accord with the approach of the Stewart case. Indeed, the Assistant Solicitor who wrote the Secretary's decision did not follow the guide lines of his superior, the Solicitor, Department of

the Interior. Testifying before the Subcommittee on Public Lands of the Committee on Interior and Insular Affairs, United States Senate, Solicitor Frank J. Barry specifically rejected a strict interpretation of the homestead requirements.

There is elasticity; I am all in favor of exercising it..

Sometimes perhaps if the elasticity appears in a particular fact situation, if the discretion, a discretionary act is possible, I assure the Senator we are most anxious to find it and to exercise whatever elasticity there may be. Hearings on S. 758, page 105, May 6, 7, 1963.
(emphasis supplied)

Senator Simpson likewise did not agree with a strict approach.

In the Government I think so, too, and I think probably it lies in this too strict adherence to the letter of the law, wherein I think you have not only the responsibility but I am sure that you have the elasticity to make proper decisions, and I think that the analogy carried between the civil and The Federal and the people see that in these cases that we point out these inequities that bring the difficulty to the Department.

I think the departments have not only the responsibility but the elasticity to make decisions, rather than to conform to the letter of the law.

I think that the elasticity is there as well as the responsibility and it could be done by the departments, a I think it is that narrow adherence to the letter of the law that doesn't give the equity where it belongs, that doesn't place the equitable load upon the person that puts you in dispute, puts our departments in disrepute with the Government or with the people, and I think it is that type of thing this committee is trying to remedy.

I don't think we are going to do any good by insisting upon just a strict adherence to the letter of the law, when you have got the power in the Department with your direction to do what is necessary. Ibid, at pages 104-5. (Emphasis supplied)

Therefore, the Secretary abused his discretion when he refused to issue patent by reason of insufficient cultivation. On the entire record, the Secretary's decision must be reversed as not being founded upon substantial evidence, and patent should issue to Appellant, with subsurface rights.

D. The Court erred by not granting Appellant's prayer for equitable relief.

By decree of the United States Supreme Court, a homesteader is not to be subjected to a strict interpretation of the homestead requirements, as suggested by the Secretary. (R 6)

The decisions of this court have established the principle that one who, in response to the invitation in the homestead law, actually settles on the public lands in an honest effort to acquire a home should be dealt with leniently and not subjected to the loss of his toil and efforts through any mistake or neglect of the officers or agents of the government. Great Northern R. Co. v. Reed, 270 U.S. 539, 546-7, 70 L.ed. 721, 725 (1926) (Emphasis supplied)

As to the second aspect, that is, the nature and character of the acts of the settler essential to initiate and preserve a claim to land as against the government, the rulings of the Land Department have been liberal towards the settler, and his good faith and honest purpose to comply with the demands of the statute have primarily been considered, thus carrying out the injunction of this court in Tarpey v. Madsen, 178 U.S. 220, 44 L.ed. 1044, 20 Sup. Ct. Rep. 849, and cases there cited, to the effect that regard should be had, in passing on the rights of settlers, to the fact that "the law deals tenderly with one who, in good faith, goes upon the public lands with the view of making a home thereon." The general course of the Land Department on the subject is illustrated by two decisions, Findley v. Ford, 11 Land Dec. 173 and Holman v. Hickerson, 17 Land Dec. 200. St. Paul M & H R Co. v. Donohue, 210 U.S. 21, 33, 52 L.ed. 941, 946 (1907) (Emphasis supplied). See also United States v. Mills, 190 F.2d 513, (5th Cir. 1911); Stewart v. Penney, 238 F. Supp. 821, 831 (D. Nev. 1965).

Instead of treating appellant with the liberality in interpretation to which he is entitled, the Department switched positions at different appellate levels, utilized in appropriate

regulations and requirements, and attempted to apply the latter retroactively. (R4-6) Appellant relied on statements of Department employees and, subsequently, the Secretary refused to consider these statements. (R4-6). Most discouraging to appellant has been the application by the Secretary of a strict interpretation of cultivation even though the Secretary concedes that there is no standard of cultivation. (R 6)

Not only is the position of the Secretary contrary to the liberal interpretation required by the United States Supreme Court, it is without a logical foundation. The type of conduct utilized by the Department in this case has led to public distrust of the Department of the Interior. One individual has suggested a complete overhaul of the "fantastically complex" regulations of the Bureau of Land Management. Howard Pollack, Anchorage Daily Times, Page 1 (7 July 1966). Similar conduct by the Department of Interior personnel has been condemned by members of Congressional committees. In words of Alaska's Senator Gruening:

The largest part of our complaints come from people who apparently have complied with the law and the regulations as they were informed they were, and then somehow out of the blue comes a decision which cancels all that, and tells them they did it wrong, and they should do it differently...

Of course, I can't remember them all, but they frequently seem to hold manifest injustices where people have appar-

ently complied, the Bureau changed its mind, the regulation has been changed, and the conditions have been changed, and the people are just out.

Senator Simpson. Will the Senator yield for a question?

Senator Gruening. Yes, indeed.

Senator Simpson. Isn't it true we have had cases from your State in which we have had to bring bills for relief for the people who have had some injustice done them as a result.

Senator Gruening. Precisely, and it is not always easy to get those through. In the case of two or three it has taken us 3 or 4 years to get one injustice rectified.

The impression widely obtains in Alaska, and this not only true of the Bureau of Land Management, it is true of almost every Federal agency, that the Government officials are enemies of the people. Instead of trying to help them, they are there to impose every possible obstacle to find flaws in everything they do.

Instead of assisting them, there is a constant struggle. Now is that necessary? It seems to me that if we want to strengthen the faith of the people in our Government which it is certainly desirable to do, we should have a different attitude.

I think maybe that is an administrative matter and it is a question of attitude. But we sometimes feel that Government officials in Alaska take the same position that they are supposed to be taking in a police state. People don't like it, and I can understand why they don't, and I don't like it. Hearings before the Subcommittee on Public Lands of the Committee on Interior and Insular Affairs, United States Senate, S. 758, pages 102-3 (May 6-7, 1963).

What is required of a homesteader is that he, in good faith

go upon the land involved and occupy and live upon the land by making the same a home to the exclusion of a home elsewhere. Great Northern R. Co. v. Reed, 270 U.S. 539, 70 L.ed. 721, 725 (1929); United States v. Richards, 149 Fed. 443, 450 (D. Neb. 1906), cert. denied. 218 U.S. 670, 54 L.ed. 1203. See also Whaley v. Northern Pac. R. Co., 167 Fed. 664, 670 (D. Mont. 1908). A homesteader who does this is entitled to equitable considerations. Massey v. Malachi, 11 L.D. 191 (1890).

Appellant resided on the land in question from 1956 through 1961. He planted timothy and rye on the requisite 20 acres. He constructed a cabin, a porch on the cabin, a basement, and built a gravel road. (R14-16). He followed carefully the soil conservation suggestions of the Soil Conservation Service. Appellant cleared land by back-breaking work. He and his wife pulled a huge log over the property to prevent erosion. Appellant made a difficult trip to Anchorage to make sure he was complying with the homestead requirements. (R22-4). Therefore, he was clearly in good faith and did occupy and live on the land, making it his home to the exclusion of a home elsewhere.

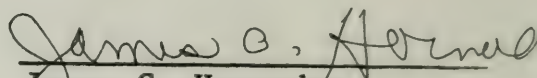
It is the position of the Appellant that he has satisfactorily complied with the homestead requirements and is entitled to the issuance of a patent to the entire 160 acres, with subsurface rights. At the very least, appellant is entitled to the issuance

of patent to 104 acres with subsurface rights. Appellant fought his way through three levels of administration appeals and received the "rubberstamp" treatment so common in these cases. Senator Simpson, Hearing before the Subcommittee on Public Lands, Committee on Interior and Insular affairs, United States Senate, page 99 (May 6 & 7, 1963). Appellant is now engaged in the second of his Judicial appeals. Clearly, he is entitled to relief.

VII. CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

FISHER and HORNADAY


James C. Hornaday

UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

No. 20667

JESS H. NICHOLAS, JR., Appellant

v.

SECRETARY OF THE DEPARTMENT OF INTERIOR,
AND THE UNITED STATES OF AMERICA,

Appellee

APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ALASKA

SUPPLEMENTAL BRIEF FOR THE APPELLANT

FISHER & HORNADAY
Box 397
Kenai, Alaska

Attorneys for Appellant

Department of the Interior are entitled to special consideration by appellate courts but that homesteaders are not entitled to any consideration by appellate courts. This argument implies that the homesteader is at the mercy of the Department of the Interior. The cases previously cited by Appellant indicate that this argument of the Appellee is without foundation. Much like the American Negro, it is now apparent that Appellant will not obtain justice from the Department of the Interior and must turn to the courts for relief. There is no other agency from which he can obtain redress for the actions of the Department of Interior which have violated the due process clause of the United States Constitution. See Bolling v. Sharpe, 347 U.S. 497, 982 L. ed. 884 (1954).

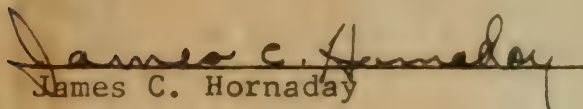
Appellant takes his stand as only one man against all of the forces which are now being asserted against him by the United States of America, Department of the Interior. Appellant has satisfied the necessary requirements to gain title to this homestead. The Department of the Interior has attempted to apply regulations against Appellant which do not even apply to Alaska.

The Department's decision rejecting Appellant's homestead final proof cites a portion of the regulations which

filed by Appellant. Accordingly, Appellant should not be subjected to a doctrine, the only justification for which is that the King of England could not be presumed to do wrong. See discussion in 2 Davis Administrative Law, §1701, et seq. Also see Moser v. United States. 341 U.S. 41, 71 S. Ct. 553, 95 L.ed. 729 (1951); Great Northern R. Co. v. Reed, 270 U.S. 539, 546-7, 70 L.ed. 721, 725, (1926); Hillstrand v. State, 395 P.2d 74, 77 (Alaska 1964); Knoble v. Orr, 27 L.D. 61 (1898).

Respectfully submitted,

FISHER & HORNADAY
Attorneys for Appellant


James C. Hornaday

20 December, 1966.

No. 20267

In The

United States Court of Appeals

FOR THE NINTH CIRCUIT

SANTA ANITA MFG. CORP., a California corporation,
Appellant,

vs.

MAX J. LUGASH and MAXON INDUSTRIES, INC., a California corporation,

Appellees-Cross Appellants,

vs.

SANTA ANITA MFG. CORP., a California corporation,
Cross Appellee.

CROSS APPELLEE'S BRIEF.

C. A. MIKETTA,
WILLIAM POMS,
GUY PORTER SMITH,

of

MIKETTA, GLENNY, POMS & SMITH, WM. B. LUCK, CLERK

210 West 7th Street,

Suite 909,

Los Angeles Calif. 90014,

Attorneys for Cross-Appellee.

FILED

JUL 21 1966

TOPICAL INDEX

	Page
Jurisdiction	1
Statement of the case	1
A. The '196 patent	2
B. The Trial Court's grounds for holding the '196 patent invalid	4
Argument	7
I.	
Plaintiffs fail to particularly point out wherein the Findings of Fact are unsupported by sub- stantial evidence	7
II.	
Plaintiffs attempt to create a new result out of mere verbiage	10
A. "A power loader"	11
B. "Attachable as a unit"	11
C. "To any desired location"	12
D. "Under a truck"	13
III.	
The purported "clearance" problem	14
IV.	
The patent statutes do not discriminate against prior knowledge	18
V.	
'196 Unitary construction was obvious to one skilled in the art	20
VI.	
'196 Claims an old combination of old elements	22

VII.

The District Court correctly found the '196 combination of old elements invalid	26
---	----

VIII.

Findings of Fact 34-35a are supported by the evidence: '196 is an obvious variant of '227 in view of the prior art	30
The presumption of validity was overcome by the non-cited prior art unitary power loaders	34
Claim 6 of '196 may not be rewritten contrary to the patentee's interpretations thereof before the Patent Office	37
Conclusion	41

TABLE OF AUTHORITIES CITED

Cases	Page
Altoona Publix Theaters, Inc. v. American Try- Ergon Corporation, 394 U.S. 477	40
Bergman v. Aluminum Lock Shingle Corp. of America, 251 F. 2d 801	25
Berkeley Pump Company v. Jacuzzi Bros., Inc., 214 F. 2d 785	24
Cataphote Corporation v. DeSoto Chemical Coatings, Inc., 356 F. 2d 24	8
Continental Connector Corp. v. Houston Fearless Corp., 350 F. 2d 183	28
Detroit Gasket & Mfg. Co. v. Victor Mfg. & Gasket Co., 114 F. 2d 868	15
Dresser Industries, Inc. v. Smith-Blair, Inc., 322 F. 2d 878	28
Farr Co. v. American Air Filter Co., Inc., 318 F. 2d 500	29
Frank B. Killian & Company v. Allied Latex Cor- poration, 188 F. 2d 940	19
Graham v. John Deere Company of Kansas City, U.S., 86 S. Ct. 684	9, 19, 22, 35
Griffith Rubber Mills v. Hoffar, 313 F. 2d 1	29
Hansen v. Colliver, 282 F. 2d 66	41
Hotchkiss v. Greenwood, 52 U.S. 248	18
Intricate Metal Products, Inc. v. Schneider, 324 F. 2d 555	31, 32, 33, 34
Jacuzzi Bros. Inc. v. Berkeley Pump Co., 191 F. 2d 632	37
Kalich et al. v. Paterson Pacific Parchment Co., 137 F. 2d 649	17

	Page
Lincoln Engineering Co. v. Stewart-Warner Corp., 303 U.S. 545	25, 27
Mannix Co. Ltd. v. Healey, 341 F. 2d 1009	19
Pursche v. Atlas Scraper and Engineering Co., 300 F. 2d 467	26, 27
Richmond Screw Anchor Co. v. Umbach, 173 F. 2d 521	14
Stearns v. Tinker & Rasor, 252 F. 2d 589	40
United States v. Adams, U.S., 86 S. Ct. 708	39
William T. Alvarado Sales Co. v. Rubaloff, 263 F. 2d 926	29

Statutes

United States Code, Title 35, Sec. 101	11, 19
United States Code, Title 35, Sec. 102	11, 19
United States Code, Title 35, Sec. 103	5, 6, 11, 19

Textbooks

2 Deller's Walker on Patents (2d Ed.), Sec. 118, p. 282, fns. 1, 2	12
---	----

No. 20267

In The

United States Court of Appeals

FOR THE NINTH CIRCUIT

SANTA ANITA MFG. CORP., a California corporation,
Appellant,

vs.

MAX J. LUGASH and MAXON INDUSTRIES, INC., a California corporation,

Appellees-Cross Appellants,

vs.

SANTA ANITA MFG. CORP., a California corporation,
Cross Appellee.

CROSS APPELLEE'S BRIEF.

Jurisdiction.

The jurisdiction of the District Court and of this Court of Appeals is admitted, this appeal being limited to the sole issue of the validity of Lugash patent '196.

Statement of the Case.

The issues of validity and infringement of Lugash '227 [Find. of Fact 6-30] and the District Court's errors with respect thereto are the subject of defendant's appeal (App. Op. Br.) which will not be duplicated here. The validity of the first Lugash '227 patent is not in issue in this appeal. This appeal concerns only Findings of Fact 31 through 35a and Con-

clusions of Law G and H. The plaintiffs' (Cross Appellants here) many references to the other findings relating to the '227 patent (Op. Br. of Cross App. pp. 2-7) are irrelevant to this appeal.

A. The '196 Patent.

"The second patent in suit, Lugash '196, is directed to the load elevator of the first Lugash patent with a unitary construction which embodies all associated working parts of the device being mounted on a main frame and attachable to the vehicle as a unit and which allows clearance by the platform of the hydraulic cylinder in the folded position." [Undisputed Find. of Fact 31, Vol. 1, p. 671].

In the prior Lugash '227 patent [Ex. 1], a main frame 3, 3 was bolted to the vehicle frame members F, F to support the power components (electric motor 32, worm gear speed reducer 18 and winch drums 26), as well as the lifting arms or linkages 42, 44 [Ex. 1, Col. 2, lines 6-61]. The winch drum cables 57 were run over pulleys 58, 61 which were mounted to the vehicle bed [Ex. 1, Fig. 1]. In the '227 alternative embodiment of Figure 9, hydraulic cylinders 70, 70 were provided for raising the lifting arms, the upper ends of the cylinders being connected to the vehicle body sill S. The '227 loader, therefore, was not entirely unitary in its construction since it could not be attached to the vehicle by only the assembling of the main frame structure 3, 3 to the truck frame members F, F.

In the '196 patent [Exs. 2 and B] a main frame member 2 is attachable to the vehicle frame members F, F by brackets 4, 4 (Figs. 1-3). Main frame 2 mounts the hydraulic cylinder 27 (on A-frame 28), lifting arms

or linkages 8, 9 and all of the power components (Fig. 7) including the electric motor 33, hydraulic fluid pump 32 and reservoir 31 [Ex. 2, Col. 3, lines 45-49]. The objects and disclosure of the '196 patent over those of the '227 patent are in the provision of a single hydraulic cylinder and a unitary construction (Gabriel, Vol. 3, pp. 649-651). Plaintiffs' patent expert, Mr. Comstock, summarized the alleged improvement of '196 as:

"A. The improvement, as I testified previously, is in making a load-lifting device of this type completely unitary so that it could be mounted at a single point on the vehicle, which would provide the proper alignment of all the operating parts, both with respect to each other and with respect to the vehicle." (Comstock, Vol. 3, p. 252).

Because of the size of platform employed and the orientation of the hydraulic cylinder employed by Lugash in the '196 patent exemplary embodiment, he created an interference between the platform and hydraulic cylinder when the platform is moved into its folded position [Ex. 2, Col. 3, lines 19-23].

"Q. And in '196 Lugash clearly did not want the platform 16 to engage the cylinder 26, as he provided a slot 17, is that correct? A. That is right." (Comstock, Vol. 3, p. 252).

No such clearance problem ever occurred in defendant's loaders [Exs. 4 and AP] wherein the platform merely folds back against and rests on the hydraulic cylinder [Exs. 5 and AP]. The complete fabrication of a problem of clearance by Lugash '196 is demonstrated by plaintiffs' own current models [Ex. 21] which elim-

inate the clearance notch 17 [Ex. 2] by merely relocating the hydraulic cylinder (note that the models shown on the covers of both brochures in Exhibit 21 mount the electric-hydraulic power unit to the truck bed, not the main frame, and do not even employ the patented unitary construction).

The Trial Court was fully advised as to the alleged improvements of the '196 patent over the '227 patent. The unitary construction and asserted clearance problem were specifically considered by the District Court in its Findings of Fact 31 through 33 [Vol. I, p. 671]. Plaintiffs do not allege error in these findings (Specification of Errors, Op. Br. of Cross App., pp. 10-11) and therefore have admitted on this appeal that the District Court correctly summarized the '196 patent [Find. of Fact 31], found the construction to be old [Find. of Fact 32], and found that no substantial difference exists in the problems of making the '196 loader unitary from that of the prior art including defendant's own prior loaders [Find. of Fact 33].

Defendant here contends that the Trial Court was compelled to hold patent '196 invalid on the facts and the authorities hereafter discussed.

**B. The Trial Court's Grounds for Holding the
'196 Patent Invalid.**

Plaintiffs incorrectly summarize the Court's Findings into a single ground for holding Lugash '196 invalid (Op. Br. of Cross App., p. 2). In the Trial Court's Findings of Fact 32 and 33 [Vol. 1, p. 671; not disputed by plaintiffs], the Trial Court found that the unitary construction of truck loaders adopted by Lugash was old in the art (including prior models of de-

fendant's own unitary truck loaders made and sold by defendant prior to the filing of the '196 patent) and that there is no substantial difference between the problem of providing plaintiffs' fold-over platform device with a unitary construction from that solved by prior art unitary devices, patents and defendant's own prior models which mounted to the truck frame as an integral unit. From this, the Trial Court concluded that the provision of unitary construction in the '196 patent was obvious to one skilled in the art at the time of plaintiffs' purported invention [Find. of Fact 35, Vol. 1, p. 672] and concluded that the patent was therefore invalid under the provisions of Title 35, U.S.C. §103 [Concl. of Law G, Vol. 1, p. 674].

The Trial Court also found that the '196 patent claims are invalid for claiming a combination of old elements which perform no novel or unusual functions in the combination not performed by them out of the combination [Undisputed Find. of Fact 33, Vol. 1, p. 671 and Concl. of Law G, Vol. 1, p. 674].

As for a third ground for holding the '196 patent invalid, the Trial Court found that the claims of patent '196 incorporate "the claims of Lugash '227 in combination with other disclosures of prior art as exemplified by defendant's Exs. AN-1, AN-4, AN-5, AN-7 and AN-8" [Find. of Fact 34, Vol. 1, p. 671]. The Trial Court considered the asserted "clearance problem" of the platform and the hydraulic cylinder and found '196 to be merely a variant of the claimed subject matter of Lugash '227 which would be obvious to one skilled in the art [Find. of Fact 35a, Vol. 1, p. 672] and correctly concluded from Findings of Fact 34 and 35a that Lu-

gash '196 is invalid as a matter of law, 35 U.S.C. §103, because "it attempts to claim the claimed subject matter of the prior Lugash patent '227 in combination with other disclosures of the prior art." [Concl. of Law G, Vol. 1, p. 674].

The alleged improvement of the '196 patent is an obvious adaptation of old unitary construction for truck loaders to plaintiffs' device which does not produce any new or different function, nor obtain an unexpected result in the '196 claimed combinations than that obtained by it in the prior art.

ARGUMENT.

I.

Plaintiffs Fail to Particularly Point Out Wherein the Findings of Fact Are Unsupported by Substantial Evidence.

Plaintiffs have failed to point out with particularity wherein the Findings of Fact 34 through 35a are asserted to be in error in their Specification of Errors (Op. Br. Cross App. pp. 10-11). Plaintiffs only express dissatisfaction with the District Court's findings and conclusions (Specification of Errors 1-3 and 7) without actually informing this Court wherein the findings are in error, complain that the District Court did not make findings favorable to plaintiffs (Specification of Errors 4 through 6) and attempt to specify error as to the issue of infringement (Specification of Error 8) which is admittedly not before this Court on this appeal. Plaintiffs never point out in their brief wherein any of the Findings of Fact of the Trial Court are clearly erroneous because unsupported by any substantial evidence or are contrary to the weight of the evidence, but rather seek to have this Court reject the District Court's conclusions based upon its findings and accept plaintiffs' contrived new result that the patented loader may be positioned beneath the vehicle "at any desired location".

"It is not our function to re-evaluate the evidence presented below. We cannot substitute our judgment for the first-hand evaluation made by the

trier of fact. * * * Our task, rather, is to determine if there exists evidence of substance to support the Findings of Fact of the Trial Court. Thus, it does not aid appellant's position on review to merely extract that evidence presented which supports its position; rather it must additionally demonstrate that no substantial evidence was presented which supports the District Court's findings in favor of appellee."

Cataphote Corporation v. DeSoto Chemical Coatings, Inc. (9th Cir., 1966), 356 F. 2d 24, 26.

Findings of Fact 31 through 33 are not specified as being erroneous. The District Court's conclusion of patent invalidity [Concl. of Law G] is supported by these Findings standing alone.

While the burden is upon plaintiffs to show that the findings are clearly erroneous and not supported by substantial evidence, defendant will hereinafter point out wherein the findings are supported by more than substantial evidence and wherein plaintiffs' assertions that the Trial Court incorrectly applied principles of law are in error.

In considering the patentability of the '196 patent, admittedly only an alleged improvement over the '227 patent, it should be kept in mind that:

"Innovation, advancement and things which add to the sum of useful knowledge are inherent requisites in a patent system which by constitutional command must 'promote the Progress of . . . useful arts.' This is the *standard* expressed in the Constitution and it may not be ignored. And it is in

this light that patent 'validity requires reference to a standard written into the Constitution.' *A. & P. Tea Co. v. Supermarket Corp.*, *supra*, at 154."

Graham v. John Deere Company of Kansas City, U.S., 86 S. Ct. 684, 688 (1966).

A review of the file history before the Patent Office [Ex. B] of the '196 patent discloses that a myriad of old elements including motors, pumps and even conduits and switches to be mounted upon the main frame were added to the claims in order to obtain the issuance of this patent by the Patent Office. While the '196 claimed combinations apparently passed the Patent Office standard, it did not meet with the aforementioned Constitutional standard of adding to the sum of useful knowledge correctly applied by the District Court.

"We have observed a notorious difference between the standards applied by the Patent Office and by the Courts. While many reasons can be adduced to explain the discrepancy, one may well be the free reign often exercised by Examiners in their use of the concept of 'invention.'"

Graham v. John Deere Company of Kansas City, *supra*, 86 S. Ct. at 694.

II.

**Plaintiffs Attempt to Create a New
Result Out of Mere Verbiage.**

Plaintiffs are required to advise this Court exactly what the purported invention of the second Lugash patent '196 is supposed to be. Their burden becomes onerous since plaintiffs admit:

“All prior loaders have a load platform, lifting arms, a supporting framework, and power means for raising and lowering the platform. In all of these, each of the parts performs its old functions, i.e., the platform supports the load, the lifting arms raise and lower the platform, the framework provides a base for the device, and the power means raises and lowers the load. All are old and are applied to perform their old functions * * *” (Op. Br. of Cross App. p. 13).

This is one of the few correct statements in plaintiffs' brief, but it is incomplete since prior art also convincingly shows that the loading platform was hinged at a connection to the lifting arms, and could be manually pivoted down (to allow dock loading) or, at the discretion of the user, it could be pivoted in an opposite direction and when in the vertical position act as a tailgate or closure, or pivoted even further in the opposite direction so as to assume a folded position. All this was old in the prior art [Exs. AD, E-G, pp. 12-13; Roberts '187, Ex. D; Novotney '403, Ex. C; Peters '577, Ex. C; Narvestad '529, Ex. C; Jester '243, Ex. D; Ducondu '011 and '473, Ex. D; Exs. AN-1 through 11, App. Op. Br.).

So plaintiffs finally state that their purported invention or new result of this old combination of elements is that it:

“* * * achieves a power loader attachable as a unit to any desired position under a truck.” (Op. Br. of Cross App. p. 15).

Plaintiffs repeat this phrase about twenty times in their brief, as if they hoped it had some mystical effect on your Honors. Let us see if this phrase answers the three prerequisites of invention: novelty, utility and non-obviousness as required by statutory law (35 U.S.C. §§ 101, 102, and 103).

A. “A Power Loader.”

A power loader and every element thereof in the same relationship for the same purpose is admittedly old and well-known in the prior art. Plaintiffs’ own admission quoted above coupled with the additional prior art which it ignores, convincingly shows that there is nothing novel in a power loader whether the platform hinges one way or another. Therefore, this portion of the mystic phrase cannot define anything patentable.

B. “Attachable as a Unit.”

Making a power loader as a unit was not first conceived by Lugash. The Trial Court had correctly found that the prior art showed power loaders attachable as a unit.

“The Trial Court felt that the non-cited art mentioned in Finding 35 was more pertinent than that considered by the Examiner in the Patent Office simply because Messick ’923, Wood ’540, and the defendant’s prior models mentioned therein all have the feature of mounting the complete power system on a main supporting framework. Specifically, in the cases of Messick and Wood ’540 they mount

the pump, motor and reservoir on the main framework, along with the hydraulic cylinder.” (Op. Br. of Cross App. pp. 31, 32).

Even on plaintiffs’ own argument it is clear that the making of an assembly from the same old elements into a unit capable of being attached to a truck is not new. The making of assemblies and subassemblies to facilitate installation was a common, obvious expedient long before the Lugash application was filed [Wachter, Duis, Park, Messick, Wood ’540, Exs. C and D]. There can be no patentable invention in forming a unitized assembly. Making a thing in one piece where it had formerly been made of several pieces has been repeatedly held to be non-inventive. (See: *Deller’s Walker on Patents*, 2d Ed., Vol. 2, §118 and p. 282, fn. 1, 2).

C. “To Any Desired Location.”

A truck has a forward cab portion, it has sides and it has a back end. Some trucks and vans have single end doors, others have double end doors and others have side doors. Can this Court say that it is invention to exercise discretion in the placement of a power loader so that it conforms to the location of a loading door or opening? It is obvious to attach an old assembly of elements wherever you desire it to perform its old function of raising and lowering loads.

Lugash did not invent the side loader concept (Shadbolt patent ’822, Fig. 1, p. 1, Col. 2, lines 97-100). The prior unitary construction of commercial loaders such as Daybrook (Wood ’540 patent; Vogel, Vol. III, pp. 391-392) as well as that of the Anthony Company loaders of Exhibit AC (Wachter, Duis and Park; Vogel, Vol. III, pp. 405-412), relied upon by the

District Court as showing unitary construction to be old [Find. of Fact 32, Vol. I, p. 671], have been employed as side loaders mounted under the vehicle bed [Exs. E-G, p. 5 and AC, p. 4]. These prior unitary construction loaders were not only mounted as side and rear loaders on vehicles but were, because of their main frame unitary construction, susceptible of being mounted "upon any base or support" [Duis '491, Col. 2, line 27, Ex. D; Wachter '221, p. 1, Col. 2, lines 35-36, Ex. C; and Park '770, Col. 2, line 32 and Col. 3, lines 12-18].

The claims of the Lugash '196 merely require a main frame member to which all associated parts are attached. It is from this main frame member that plaintiffs derive their theory that the loader can be attached *anywhere* beneath the vehicle bed. But this same construction and unitary mounting of powered loaders on a single main frame member is clearly found in the prior art of unitary loaders mounted at the rear or side of vehicles, beneath the vehicle bed, or *on any other support*.

D. "Under a Truck."

Where else would you attach a truck loader? No intelligent man would attach it to the cab or place a loader mechanism on the top surface of a truck bed where it would interfere with loading.

Plaintiffs' own definition of the purported "invention" and "new result" shows that no patentable invention exists in the secondary Lugash patent '196. Plaintiffs are "scraping the bottom of the barrel" when they are forced to advance such an untenable definition of the purported "new result." A new result is not ob-

tained by stating that the old device can be moved and attached as a unit in “any desired location” at the discretion of the purchaser. The device, no matter what its location, would still simply lift and lower loads. The patent laws cannot preclude intelligent men from using common sense. Patents cannot be sustained where they merely rely on semantics.

“It has been frequently held that a second patent must be for an invention separate and distinct from that claimed in a former patent and that *mere differences in the scope or language of the claims do not constitute a separate and distinct invention*. Miller v. Eagle Mfg. Co., 151 U.S. 186, 198, 14 S.Ct. 310, 38 L.Ed. 121; Caldwell v. Firestone Tire & Rubber Co., D.C., 13 F.2d 483, 488, affirmed 2 Cir., 23 F.2d 1000; Palmer Pneumatic Tire Co. v. Lozier, 6 Cir., 90 F. 732, 744.” (Emphasis added).

Richmond Screw Anchor Co. v. Umbach (7th Cir., 1949), 173 F. 2d 521, 526.

III.

The Purported “Clearance” Problem.

Being hard-pressed for an argument to sustain this secondary Lugash '196 patent, counsel for plaintiffs have indulged in “the discovery of a clearance problem” (Op. Br. of Cross App., p. 26, line 2). This non-existent “clearance problem” was apparently no problem to Lugash [who merely cut a notch 17 in the platform, Ex. 2, Fig. 2] but is rediscovered here by counsel for purposes of this case.

“* * * The discovery of the problem does not constitute invention, and if the device of Balfe in all its essential elements is covered by the disclosures

of Hill and Salesky with only such mechanical changes or improvements as would occur to one skilled in the art, when confronted with the particular problem, the creation of the device does not constitute invention.”

Detroit Gasket & Mfg. Co. v. Victor Mfg. & Gasket Co. (C.A. 7, 1940), 114 F. 2d 868, 872.

The only alleged improvement of Lugash '196 is in the making of the '227 loader as a unit attachment with one hydraulic cylinder rather than the two side mounted cylinders in the '227 patent (Gabriel, Vol. III, pp. 649-651). The provision of a single centrally located hydraulic cylinder 26 [Ex. 2, Fig. 3] in a powered loader in place of two side mounted cylinders 70 [Ex. 1, Fig. 9] was obvious to those skilled in the art from the commercially available Anthony Company loaders as shown in any of the Wachter '221, Novotney '424 or Duis '491 patents (Gabriel, Vol. III, pp. 652-658; Vogel, Vol. III, pp. 403-412).

Having thus positioned the hydraulic power cylinder in conventional manner between the lifting arms, as in the prior loaders Lugash was undoubtedly aware of (his son Murray became familiar with the Anthony tail-gate loaders *the day* his father started building the Tuk-A-Way loader, Vol. III, p. 313), Lugash merely provided a notch 17 in the platform so that he could retain its length only slightly less than the length of the lifting and lazy bars 8 and 9 [Ex. 1, Col. III, lines 19-23] without the platform hitting the hydraulic cylinder. In defendant's accused devices, the platform merely folds back against and lies *on* the hydraulic cylinder of defendant's prior unitary construction loader

[Ex. 5; Gabriel, Vol. III, pp. 683, 690, 724-725, 754, 757, 760]. If a clearance problem ever existed which had to be solved by the provision of a clearance notch in '196, defendant has not used the solution and it has been abandoned by plaintiffs in their modern "Tuk-A-Way" loader constructions which do not include notches [Ex. 21].

Plaintiffs now state that this "problem" was not previously known to the art and that no evidence was presented on any liftgate that had the parts arranged in a manner to permit inversion of a load platform "without interfering with the hydraulic cylinder" (Op. Br. of Cross App., p. 23). Inverting of the platform and raising of the lifting arms in any of the Novotney '403, Narvestad '529 (Figs. 5-7) or Jester '243 patents would not interfere with the operation of the power means. In defendant's loaders, the platform merely lies back on the cylinder without any clearance between the platform and cylinder and without any notches providing such clearance (Vogel, Vol. III, pp. 472-480, Gabriel, Vol. III, pp. 724-725, 754, 757-758). There is no clearance problem in providing an old unitary power loader with connections between the lifting arms and platform to allow the platform to fold backwardly against the cylinder. Defendant's prior unitary construction of its EB-1500 loader [Ex. X] is used in the accused Folda-Lift loaders [Exs. 4, 5] with merely the platform being hinged to allow it to fold back *against the cylinder*. If one does not want the platform to abut against the cylinder, he can simply cut a notch in the platform.

Certainly it would be obvious to anyone that to allow a hinged element (whether it is a platform, a panel or a trap door) to pivot beyond an obstruction (hydraulic

cylinder), you can either move the obstruction or cut a notch in the hinged panel. Lugash originally cut a notch 17 in the platform [Ex. 2, Fig. 3] and later merely moved the hydraulic cylinder to a more horizontal position so that it was not an obstruction [Ex. 21]. A carpenter often trims the edge of a hinged element (known as a door) to avoid a thick carpet and permit the door to close flush. Hinged covers for fuse and relay boxes often have a notch in them to avoid hitting a latch or hasp. These solutions are obvious to men of ordinary skill; they were taken care of in the past without fanfare.

It would be obvious to any handyman who has seen a folding chair that to fold a platform or seat into a small space it would be desirable to have the platform between the legs with in folded position, etc. Obviously, proportions, distances widths, etc. may vary — these are all matters of degree. The size of the cylinder may vary with the load you expect to carry on the loader; the level of the pivot point of the cylinder may be varied as well as the length of the lifting arms since truck beds are of different heights above ground. But these variations in degree are within the skill of the art. They do not rise to the dignity of invention.

“There is the old rule that one is not entitled to a patent who merely makes a change in form, proportion or degree, by substantially the same means even though the changes he makes produce better results.”

Kalich et al. v. Paterson Pacific Parchment Co.
(9th Cir., 1943), 137 F. 2d 649, 652.

When a farmer cut a notch in the edge of a trap door leading to the well, so as to permit the trap door to miss

the moving pump rod, he did not make an invention. He solved his "clearance problem" by the use of common sense. Common sense is not to be monopolized by plaintiffs under the guise of a patent.

"It may afford evidence of judgment and skill in the selection and adaptation of the materials in the manufacture of the instrument for the purposes intended, but nothing more."

Hotchkiss v. Greenwood, 52 U.S. 248, 266.

The inescapable fact is that there is nothing in the claims which inventively, non-obviously, distinguishes from the ordinary skill of the calling as shown by the prior art.

IV.

The Patent Statutes Do Not Discriminate Against Prior Knowledge.

Plaintiffs attempt to minimize some of the evidence relating to prior knowledge [as shown in patents in Exs. C and D] by alleging that those devices did not come into successful use in the trucking industry. Plaintiffs' allegations are untenable for the following reasons:

1. Prior knowledge may be expressed in the form of patents, texts or publications or evidence of personal knowledge and usage.
2. So-called paper patents are just as effective as anticipations as the most widely sold product of General Motors.

"Appellant attempts to minimize the teachings of the prior art patents by referring to them as 'paper art' which had not been put to commercial

use, manufactured or sold. This is irrelevant to the question whether the *disclosures* therein constituted anticipation. *Edward Valves, Inc. v. Cameron Iron Works, Inc.*, (5 Cir., 1961), 286 F.2d 933, 939; *Tillotson Manufacturing Co. v. Textron, Inc., Homelite*, (6 Cir., 1964), 337 F.2d 833, 837."

Mannix Co. Ltd. v. Healey (5 Cir., 1965), 341 F. 2d 1009, 1010.

"* * * The phrase, 'paper patent,' is a mere bit of rhetoric, usually employed as a makeweight by judges who wish to support the patent in suit, but are embarrassed by a reference, of an escape from which they are not too confident. It is a meaningless platitude."

Frank B. Killian & Company v. Allied Latex Corporation (2 Cir., 1951), 188 F. 2d 940, 942.

3. The patent statutes 35 U.S. Code §§ 101, 102 and 103 do not impose "successful use" limitations on what is prior knowledge. The patent in suit must be unobvious in the light of all prior knowledge. The Supreme Court stated:

"* * * It is also irrelevant that no one apparently chose to avail themselves of knowledge stored in the Patent Office and readily available by the simple expedient of conducting a patent search—a prudent and nowadays common preliminary to well organized research. *Mast, Foos & Co. v. Stover Mfg. Co.*, 177 U.S. 485 (1900)."

Graham v. John Deere Company of Kansas City, supra, 86 S. Ct. 684, 703 (1966).

Therefore, this Court cannot disregard prior patents which show invertible platforms and unitary loader assemblies even if these prior patents allegedly were not commercially exploited when they were invented.

V.

**'196 Unitary Construction Was Obvious
to One Skilled in the Art.**

The earliest date for Lugash '196 is its filing date, September 27, 1957. Contrary to plaintiffs' statement at page 5 of their Brief, there is no evidence of commercial production of the Tuk-A-Way loaders of patent '196 in early 1957 [Ex. D, the Depo. of Pltff. Lugash was never introduced into evidence].

The prior models of defendant's loader which were of a unitary construction referred to by the District Court in its Findings are exemplified by the prior EB-1200 model loader [Exs. N, O, S, Vol. III, p. 425; Ex. T, Vol. III, p. 427] and the same heavier constructed EB-1500 [Ex. X]. Defendant's EB-1500 FL loader of plaintiffs' Exhibit 4 (accused to be an infringement of Lugash '196) differs from defendant's prior unitarily constructed EB-1200 and EB-1500 loaders only in the hinging and size of the platform and the provision of a body spacer on the rear end of the truck (a non-claimed element) [Vogel, Vol. III, pp. 442-445].

In 1960, when defendant modified its existing unitary construction EB-1500 loader to obtain the EB-1500 FL loader, the inverting of the platform was a simple matter which did not require retooling nor changes major in character [Find. of Fact 13A, Vol. I, pp. 665-666]. In fact the photographs for both defendant's brochures, Exhibit 4 and Exhibit X, were

made of the same truck with merely the platforms being replaced [Vogel, Vol. III, pp. 442-445]. There was *no problem* in adapting the defendant's prior art unitary construction for tailgate loaders to the EB-1500 FL loader. The platform was merely made smaller and hinged so that it could fold back against the hydraulic cylinder [Ex. 5].

When Lugash mounted a single hydraulic cylinder centrally of the lifting arms on the main frame of the '196 patent [in the identical position as shown in Wachter patent 2,389,221, Ex. C, commercially available prior to Lugash '196 as the Anthony Liftgate, Ex. AC] he merely provided a simple notch 17 [Ex. 2, Fig. 2] so that the platform would invert back on the lifting linkage *without* hitting the cylinder stating:

“* * * It will also be noted that the length of the platform is only slightly less than the length of the lifting and lazy bars 8 and 9 and that the notch 17 in the platform provides the required clearance for the piston rod.” [Ex. 2, Col. 3, lines 20-23; Ex. E-V].

Subsequently, the platform notch was eliminated by Lugash by his merely relocating the hydraulic cylinder [Ex. 21].

The District Court correctly found that there is no substantial difference insofar as concerns the problem of unitary construction in the plaintiffs' Tuk-A-Way device including a fold-over platform moved to and from the out-of-the-way position of the truck bed and the problem of unitary construction of the devices in the prior art patents and in *defendant's prior models* [Undisputed Find. of Fact 33, Vol. I, p. 671]. There was no problem unsolved by the prior art. All Lugash

'196 accomplishes is the provision of the folding platform (claimed in '227) in the old unitary power loaders of the prior art.

*** The Scoggin invention, as limited by the Patent Office and accepted by Scoggin, rests upon exceedingly small and quite non-technical mechanical differences in a device which was old in the art. At the latest, those differences were rendered apparent in 1953 by the appearance of the Livingstone patent, and unsuccessful attempts to reach a solution to the problems confronting Scoggin made before that time became wholly irrelevant. *** To us, the limited claims of the Scoggin patent are clearly evident from the prior art as it stood at the time of the invention."

Graham v. John Deere Company of Kansas City, supra, 86 S. Ct. 684, 703 (1966).

VI.

'196 Claims an Old Combination of Old Elements.

The claims of Lugash '196 are directed to the old combination of main frame member, parallel rule linkage means, load receiving platform hingedly mounted on a platform supporting member connected to the lower end of the linkage means and power means for raising and lowering the linkage means.

The Trial Court found and it is not disputed that the claims of patent '196 are directed to a combination of old elements which perform no novel or unusual functions in the combination not performed by them out of the combination [Undisputed Find. of Fact 33, Vol. I, p. 671].

Plaintiffs carefully have omitted directing the Appellate Court's attention to the actual claims of the '196 patent. These claims and the application of the prior art thereto are fully set forth in defendant's Exhibit AN. The Court's attention is directed thereto. For example, the Lugash '196 claim 1 and 2 combinations of a main frame member (orange), parallel rule linkage means (green), platform supporting member (yellow), hinged mounting of a platform (blue) to the platform supporting member (yellow) and power means (brown) are all found in both the Novotney '403 reference [Exs. AN-2, 3] and the claimed subject matter of Lugash '227 [Ex. AN-1]. In this old combination of old elements, the specific positioning of the power cylinder, electric motor, hydraulic fluid pump, fluid supply source and hydraulic connections all on the main frame member (orange) rather than on the other parts of the vehicle are obvious modifications within that old combination suggested by any of the prior art Messick, Wachter or Wood patents.

The combination of elements of claim 4 are shown to be an old combination claimed in Lugash '227 in each of Exhibits AN-4, 5 and 6. The old combination and complete anticipation of the unitary construction of Lugash '196 claim 6 by any of the prior art Messick, Wood or combination of Vogel and Spitler references are shown in Exhibits AN-9, AN-10 and AN-11.

The Lugash '196 claims define an old combination in which each of the elements continues to perform its old function in the old combination.

“We summarize what we conceive to be the now exacting rule laid down in the A. & P. Tea case. There the court cites with approval its former de-

cision in *Lincoln Engineering Co. v. Stewart-Warner Corp.*, 303 U.S. 545, 549, wherein it said: ‘the mere aggregation of a number of old parts or elements which, *in the aggregation, perform or produce no new or different function or operation than that theretofore performed or produced by them* (the old parts), is not patentable invention.’

* * *

“From the foregoing language we must and do assume that the court was simply saying that where a mechanical combination device represents only an integration of various old elements and the combination clearly reveals that its old elements thus brought into conjunction or correct do not *functionally operate differently therein* than they did before integration, then it is not a patentable invention. In other words, this sort of an integration does not add to the sum of useful knowledge or to the total stock of knowledge and the expert mechanical skill employed in creating it has not made the device ‘exceed the sum of its parts.’ If the evidence clearly establishes that the device is of the type just above described, it obviously lacks the quality of invention. In that event a trial judge is justified, as a matter of law, in directing a jury to return a verdict against patentability. And this rule applies regardless of the scope and breadth of the claims of such a patent, because patent claims may not override such established physical facts.” (Emphasis added).

Berkeley Pump Company v. Jacuzzi Bros., Inc.
(9th Cir., 1954), 214 F. 2d 785, 787, fn. 2.

There is no new result nor novel combination in Lugash '196. Finding 33 and the rule in *Lincoln Engineering Co. v. Stewart-Warner Corp.*, 303 U.S. 545, 549, support the District Court's Conclusion of Law G that the Lugash '196 patent claims are invalid because they are merely a combination of old elements in which such old elements perform no new, novel or unusual functions in the combination that they did not previously perform in the prior art [Concl. of Law G, Vol. I, p. 674].

"In the Kwikset Locks case, *supra*, 210 F.2d at page 486, we pointed out that, in *Atlantic & Pacific*, *supra*, 'the Supreme Court further requires that in order for a combination patent to be upheld, there must be a specific finding that the old elements which make up this device perform an additional and different function in combination, than they perform out of it.'

"As in Kwikset Locks, 'no such finding was made in the case at bar.' Regardless of any other defect, such a lack makes it impossible for the present decree to be sustained."

Bergman v. Aluminum Lock Shingle Corp. of America (9th Cir., 1957), 251 F. 2d 801, 808.

In this case, the District Court not only did not fail to make a finding of new and different functions for the claim elements in the combination as required by this Court for patent validity in the *Bergman* case, *supra*, it specifically found that each of the old elements does *not* perform any new or different function in the combination not previously performed by them in the prior art [Find. of Fact 33, Vol. I, p. 671].

VII.

The District Court Correctly Found the '196
Combination of Old Elements Invalid.

Plaintiffs admit that the various elements in Lugash '196 do not perform any new functions in the claimed combinations not previously performed by them in the prior art (Op. Br. of Cross App. p. 17). The correctness of the District Court's Finding 33 to this effect is not disputed but, plaintiffs assert that the Finding is insufficient to hold the claims invalid under this Court's theory in *Pursche v. Atlas Scrapper and Engineering Co.* (9th Cir., 1962), 300 F. 2d 467 (Op. Br. of Cross App. pp. 15-21).

In the *Pursche* case, *supra*, the District Court had specifically found as to the '090 patent claims held valid that:

“* * * the elements of the plow share carrier rotating device ‘performs an additional and different function in combination than they perform out of combination.’”

Pursche v. Atlas Scrapper and Engineering Co., supra, page 472.

But as to other claims of the '090 patent:

“‘it is not necessary that all of the elements of the claim be found in one prior patent. If they are all found in different prior patents and no new functional relationship arises from the combination, the claim cannot be sustained.’ *Eagle v. P. & C. Hand Forged Tool Co.*, 74 F.2d 918, 920 (9th Cir. 1935).

“Since no new function nor any surprising or unusual circumstances would arise from placing the Unterilp tail wheel on the plow described in the

Capon patent, we conclude that claims * * * of the '090 patent are invalid for they merely recite what already existed in the prior art."

Pursche v. Atlas Scrapper and Engineering Co., supra, page 475.

There is no different rule of law in the *Pursche* case, *supra*, from that of *Lincoln Engineering, supra*. The same test was applied in both. However, contrary to the factual finding of a new function for some of the old elements in the '090 patent claims by the District Court in *Pursche, supra*, the District Court here has correctly found that there are no new functions for the old elements of Lugash '196 [Undisputed Find. of Fact 33, Vol. I, p. 671; Concl. of Law G, Vol. I, p. 674].

The provision of a main frame upon which all associated parts are mounted in the '196 loader does not produce any new function or surprising or unexpected consequences for any of the old elements found in '196. The District Court correctly applied the rule of *Lincoln Engineering* that:

"* * * The mere aggregation of a number of old parts or elements which, in the aggregation, perform or produce no new or different function or operation than that theretofore performed or produced by them, is not patentable invention."

Lincoln Engineering Co. v. Stewart-Warner Corp., supra, 303 U.S. at 549-550,

and found '196 invalid upon the undisputed factual finding [Find. of Fact 33].

The claims of the Lugash '196 patent, as readily seen from an examination of defendant's Exhibit AN, are merely an aggregation of a number of old parts or ele-

ments [main frame, platform, linkage, hydraulic cylinder and piston means, reservoir, pump, motor, switch, conduits, manual valve, platform supporting member, hinge and stop; claim 4, Exh. 2] each of which continues to perform its same old function and operation in the combination as that performed out of it.

This Court has repeatedly held such combinations of old elements invalid:

“Here the spring gripped the male insert, springs had thus functioned before. S-springs functioned to produce a greater area of contact with the insert. They had so functioned, to a greater or lesser degree, in the prior art. * * * This was, at best, an improvement in efficiency of function, but not the creation of a new, different or additional function, or a new or different result. It was not unexpected. It was at best the ‘mincing step forward’ described in 69 C.J.S. Patents §§ 204, 213, pp. 686-87, 726-27.”

Continental Connector Corp. v. Houston Fearless Corp. (9th Cir., 1965), 350 F. 2d 183, 191.

“The A. & P. case sets forth a test for determining whether or not there has been invention when there is a conjunction of known elements: the unification of the elements must result in unusual or surprising consequences; the old elements which make up the device must perform some additional or different function * * *.”

Dresser Industries, Inc. v. Smith-Blair, Inc. (9th Cir., 1963), 322 F. 2d 878, 889.

“Whether River’s contribution is of sufficient novelty to be patentable is therefore a question of law, based upon the rule that a combination of old elements is patentable invention only if the elements take on some new quality or function by being brought into concert and their combination results in unusual or surprising consequences.”

Farr Co. v. American Air Filter Co., Inc. (9th Cir., 1963), 318 F. 2d 500, 502.

“* * * As in the case of other combinations of ideas drawn from existing knowledge, the old elements, including the known material in the new use, must perform additional and different functions in the combination than out of it; the results must be unusual and surprising — more must be derived from the combination than that which might be reasonably expected as the sum of the old ideas drawn from the public domain.”

Griffith Rubber Mills v. Hoffar (9th Cir., 1963), 313 F. 2d 1, 4.

“Applying the test of the A. & P. case to the uncontroverted facts before us here, we hold that the Trial Court did not err in concluding that the George device is a non-patentable aggregation of old components and therefore invalid. Its components do not perform any additional or different function in the combination than they perform out of it.”

William T. Alvarado Sales Co. v. Rubaloff (9th Cir., 1959), 263 F. 2d 926, 930.

VIII.

Findings of Fact 34-35a Are Supported by the Evidence: '196 Is an Obvious Variant of '227 in View of the Prior Art.

Plaintiffs fail to support their bare allegation that Findings of Fact 34 to 35a are clearly erroneous. The District Court's Findings of Fact 34 through 35a are supported by substantial evidence presented at trial.

Plaintiffs concede that the Trial Court correctly recognized that to be valid, Lugash '196 must be a distinct patentable advance over what was claimed in Lugash '227 (Op. Br. of Cross App. pp. 6-7). Plaintiffs attempt to rely upon Finding of Fact 8 [Vol. I, p. 664] as demonstrating the claimed subject matter of Lugash '227, claim 8 conveniently omitting any reference to a frame structure (supposedly the additional element providing a new unitary combination in Lugash '196). However, as shown in defendant's Exhibit AN, the combination of platform, power means, frame structure, parallel rule linkage systems and hinged connections for allowing folding of the platform are all old elements in an old combination as to Lugash '196 because actually claimed in the prior Lugash '227 patent claims [Exs. AN-1, 5, 6, 7 and 8; Gabriel, Vol. III, pp. 734-748, Vol. I, pp. 289-309].

The District Court found the unitary construction (not claimed in '227) of Lugash '196 to be old in powered loaders as demonstrated by the prior Messick, Wood and other patents [Exs. C, D] as well as the defendant's own power loaders made and sold prior to Lugash '196 [Undisputed Find. of Fact 32, Vol. I, p. 671].

The folding concept in Lugash '196 was claimed in the '227 patent and therefore is not of patentable significance in the '196 patent. The claims of the '196 patent merely incorporate the claimed subject matter of Lugash '227 in combination with other disclosures of the prior art as exemplified by defendant's Exhibits AN-1, AN-4, AN-5, AN-7 and AN-8 [Find. of Fact 34, Vol. I, pp. 671-672; Gabriel, Vol. I, pp. 289-309, Vol. III, pp. 734-748] The District Court correctly concluded that the Lugash patent '196, including the problem of platform clearing the hydraulic cylinder piston, is a variant of the claimed subject matter of Lugash '227 which would be obvious to one skilled in the art [Find. of Fact 35a, Vol. I, p. 672; Vogel, Vol. III, pp. 422-432, 442-445, 446-450, 456, 473, 476-480; Gabriel, Vol. III, pp. 658, 664, 734-748, 833-835].

Plaintiffs only assert that the Trial Court should have reached a different conclusion because of a supposed misapplication of the prior ruling of this Court in *Intricate Metal Products, Inc. v. Schneider* (9th Cir., 1963), 324 F. 2d 555 (Op. Br. of Cross App. pp. 22-30). This Court stated in the *Intricate Metal* case, *supra*, with respect to patents issued to the same inventor wherein the applications were copending before the Patent Office that:

"The first patent does constitute a prior art reference as to what it claimed. The significance of the fact that No. 690 was pending when No. 490 was filed is simply that the inventive advance of 490 must be over what was claimed in the 690 application and need not be over the totality of its disclosure as would otherwise be the case."

Intricate Metal Products, Inc v. Schneider, supra,
page 560.

Plaintiffs have admitted that the District Court probably recognized this requirement:

“The Trial Court recognized that the patentable advance of Lugash’s improvement patent would have to be over only what was claimed in his copending generic patent and need not be over the totality of its disclosure as would be the case if the patents were not copending.” (Op. Br. of Cross App. pp. 6-7).

This Court in the *Intricate Metal* case, *supra*, went on to state:

“In the case before us, No. 490 does not claim unpatented disclosures of No. 690. Rather, *it incorporates the claims of the earlier patent in combination with the other disclosures of prior art.* * * *, no one could manufacture the 490 sofa bed without infringing No. 690. * * *

“We conclude that patent No. 490 is invalid for lack of invention. . . .” (Emphasis added).

Intricate Metal Products, Inc. v. Schneider, supra, page 561.

The District Court did not misapply the *Intricate Metal* case. It correctly followed the advisement of this Court in holding the Lugash ’196 patent invalid because it found as a matter of *Fact* that:

“The claims of patent ’196 incorporate the claims of Lugash ’227 in combination with other disclosures of prior art, as exemplified by defendant’s Exhs. AN-1, AN-4, AN-5, AN-7 and AN-8.” [Find. of Fact 34, Vol. I, pp. 671-672].

The District Court concluded that the “other disclosures of prior art” in addition to the “claimed subject matter”

of the former '227 patent rendered the second patent invalid. While plaintiffs urge a supposed clearance problem, it is apparent that the District Court considered this in its decision and found to the contrary in stating:

“The folding platform was claimed in Lugash patent '227. It appears that Lugash patent '196, *including the problem of the platform clearing the hydraulic cylinder piston*, is a variant of the claimed subject matter of Lugash '227 which would be obvious to one skilled in the art.” [Emphasis added; Find. of Fact 35a, Vol. I, p. 672].

Plaintiffs contradict themselves attempting to allege error in the District Court in applying the *Intricate Metal Products'* case to the facts of this action. Plaintiffs admit that the District Court correctly recognized the *Intricate Metal Products'* rule (Op. Br. of Cross App. pp. 6-7). The District Court did not ignore the supposed clearance problem [Find. of Fact 35a] and plaintiffs fail to show that there is no evidence to support the Court's conclusion that notwithstanding such alleged problem, the '196 patent is merely an obvious variant over the claimed subject matter of Lugash '227. Plaintiffs' argument again reduces merely to the verbiage of placing the old combination of unitary hydraulically powered load elevator “any place under the truck” (Op. Br. of Cross App. p. 25). The District Court was fully advised as to the unitary construction of plaintiffs' loader [Undisputed Find. of Fact 31]. The Trial Court found and plaintiffs do not dispute that there is no difference in the problem of unitary construction in the plaintiffs' device and that disclosed in the loaders of the prior art patents and the defendant's own prior models [Undisputed Find. of Fact 33].

Findings of Fact 34 through 35a are supported by more than substantial evidence and compel the legal conclusion that the '196 patent is invalid "because it attempts to claim the claimed subject matter of the prior Lugash patent '227 in combination with other disclosures of the prior art" [Concl. of Law G, Vol. I, p. 674; *Intricate Metal Products, Inc. v. Schneider, supra*, p. 561].

The Presumption of Validity Was Overcome by the Non-Cited Prior Art Unitary Power Loaders.

It is admitted that the Patent Office did not have a reference before it which showed the claimed unitary construction of the '196 patent wherein all components including the electric motor, hydraulic pump and fluid reservoir, are also mounted on a main frame member (Op. Br. of Cross App. pp. 31-32). This so-called unitary construction was asserted to the Patent Office by the patentee as a basis for issuing the '196 patent and is the only real structural difference in '196 over the claimed subject matter of '227 [Ex. 2, Col. 3, lines 45-49; Gabriel, Vol. III, pp. 649-651; Comstock, Vol. III, p. 252; Ex. AN].

"To make the nature of the invention sought to be protected still more clear, the specification has been slightly amended to point out that applicant's invention relates to a device which is attachable to a vehicle as a unit as distinguished from the prior art structures in which, so far as the cited references are concerned, includes devices which must be attached to the vehicle at numerous separated points." [Ex. B, pp. 18-19].

". . . applicant's device is a unit in which all associated working parts are mounted on a main frame member and therefore the operating align-

ment of the various parts is accurately preserved.” [Ex. B, p. 19].

“It is believed that the Examiner has misconstrued the disclosures of applicant’s prior patent and Ornsby. Neither of these patents show the unitary structure alleged.” [Ex. B, p. 22].

“... the claims have been amended to stress this unitary type of construction and, as pointed out above, this unit construction is not to be derived from either applied reference nor from any combination of them.” [Ex. B, p. 22].

None of the references relied upon by the Patent Office in acting on the ’196 patent [Ex. 2: Narvestad ’529, Wood ’135, Ornsby ’938, Lugash ’227 and Roberts ’187, Exs. C, D] disclosed or claimed a power loader for vehicles which could be mounted to the vehicle chassis by a single main frame member.

“... It is crystal-clear that after the first rejection, Scroggin relied entirely upon the sealing arrangement as the exclusive patentable difference in his combination. It is likewise clear that it was on that feature that the Examiner allowed the claims.

* * *

“Here, the patentee obtained his patent only by accepting the limitations imposed by the Examiner. The claims were carefully drafted to reflect these limitations and Cook Chemical is not now free to assert a broader view of Scroggin’s invention. The subject matter as a whole reduces, then, to the distinguishing features clearly incorporated into the claims.”

Graham v. John Deere Company of Kansas City, supra, 86 S. Ct. at 30, 32.

The Patent Office did not have the best prior art before it. However, the District Court was well-advised as to the state of the prior art including the prior Messick '193, Wood '540, Wachter, Duis and Park patents [Exs. C, D] and *defendant's own prior unitary loaders* [Find. of Fact 32]:

"It will be observed that the whole assembly, including the hangers, motor, fluid supply lines, platform and the actuating arms and the links are all carried by the torque tube 7 and thus may be assembled at the factory and placed into position on the truck by the mere application of the tie rods or bolts 10. This, as before stated, avoids the necessity of a great deal of laborious work made necessary where the truck frame has to be drilled to receive special fittings." [Messick, Ex. C, Col. 3, lines 18-26].

". . . this invention provides a self-contained power actuated tailgate unit attachable to the open rear end of the box body, the unit comprising all operating components and accessories, to wit, a tailgate or platform, an elevation mechanism or parallel motion device for the platform, a hydraulic operating system for the elevating mechanism complete with pump, power cylinder means, pressure oil lines, oil reservoir and a manually operable control valve unit, and further more significantly, an electric motor for driving the pump. . . ." [Wood '540, Ex. C, Col. 2, line 7 *et seq.*].

In view of these prior unitary construction loaders, the presumption of patent validity as to the Lugash '196 patent in suit was clearly overcome.

“Even one prior art reference which has not been considered by the Patent Office, may overthrow the presumption of validity, and, when the most pertinent art has not been brought to the attention of the administrative body, the presumption is largely dissipated. Such is the case here.”

Jacuzzi Bros. Inc. v. Berkeley Pump Co. (9th Cir., 1951), 191 F. 2d 632, 634, fn. 4, page 637.

Claim 6 of '196 May Not Be Rewritten Contrary to the Patentee's Interpretations Thereof Before the Patent Office.

Plaintiffs attempt to rewrite claim 6 of the '196 patent to include the folding concept not expressed therein. Even assuming that this would be proper (which it is not), the District Court's conclusion of invalidity for the '196 patent previously discussed would not be affected. The District Court found all claims in issue invalid, including claims similar to plaintiffs' proposed modification of claim 6.

Claim 6 merely recites a unitary powered load elevator completely anticipated by Messick '923 [Ex. AN-9], Wood '540 [Ex. AN-10] and defendant's own prior unitary EB-1200 and EB-1500 loaders [Exs. N-X]. Claim 6 is an embarrassment to plaintiffs because its broad claiming of a unitary construction in any type of power loader emphasizes that it was this single allegedly distinguishing feature of unitary construction which caused the allowance of the '196 patent by the Patent Office. There was no inadvertent omission of the folding concept from claim 6 of Lugash '196. The second object of the patent is specifically directed to a broad unitary power loader, the patentee stating:

“Another object of the invention is to provide a platform type hoisting apparatus attachable as a unit to loader trucks or light vehicles including hydraulically actuated means for lifting the platform and in which the power means is mounted on the main frame member for the hoist whereby the entire hoist and its power unit form a complete assembly or unit for attachment to the vehicle.” [Ex. 2, Col. 1, lines 22-28].

When the Patent Office failed to find any reference which showed a unitary construction for a power loader, the patentee added claim 6 (application claim 9) by an amendment dated November 16, 1959 [Ex. B, p. 22]. After pointing out that no cited reference disclosed or claimed a unitary construction, the patentee expressly interpreted the newly added claim as follows:

“New claim 9 is presented as a broader expression of the invention above described, it being believed to be self-evident from the nature of the cited references, as above discussed, that applicant is entitled to a claim at least as broad as this new claim 9. It is specifically directed to the unitary structure comprising the main frame which supports *all* the components of the device and the components other than the main frame are believed to have been recited in this claim in sufficient particularity to constitute an operative whole.” [Ex. B, p. 23].

The patentee expressly stated to the Patent Office that the issue claim 6 was a “broader expression” of the alleged unitary construction invention. The distinguishing feature was asserted to be that the unitary construction included a main frame member which sup-

ported “*all* the components of the device”. Significantly, the patentee’s statement shows that the folding concept was deliberately left out of claim 6 because it was believed that the other elements recited constituted an “operative whole” without the folding concept. The patentee’s contentions that there was no unitary construction in the prior art to anticipate this application claim 9 was repeated in subsequent remarks [Ex. B, p. 27] and the patent was allowed [Ex. B, p. 29].

Claim 6 of Lugash ’196 was thus presented to the Patent Office as being a broader statement of the alleged unitary construction invention and asserted to claim an operative whole. Such was not the case in *United States v. Adams*, U.S., 86 S. Ct. 708 (1966). In *Adams, supra*, the electrolyte not referred to in the claims was a *necessary* element to the claimed battery (86 S. Ct. at 713). In Lugash, the folding concept is not a necessary element. In fact, the patentee asserted the direct opposite to the Patent Office in stating that the unitary power loader claimed was an “operative whole”. Also, Adams had uniformly asserted that the missing necessary element was a water electrolyte:

“In his first contact with the government less than a month after the patent application was filed, Adams pointed out that ‘no acids, alkaline or any other liquid other than plain water is used in his cell. Water does not have to be distilled. . . .’”

United States v. Adams, supra, 86 S. Ct. at 713.

Further, in *Adams, supra*, the District Court had found and the government apparently *admitted* on appeal that the Adams’ battery obtained a “wholly unexpected” result (86 S. Ct. at 714). Here, the asserted

distinguishing features of a unitary construction in a folding platform loader do not produce any unexpected results but are merely the expected, obvious result of combining the admittedly old elements. Claim 6 fails to define a patentable advance over the art and cannot be saved by reference to the specification or other claims.

“As none of the flywheel claims as drawn define an invention, none can be aided by reading into it part of the specification, or of other claims, which the patentees failed to include in it.”

Altoona Publix Theaters, Inc. v. American Try-Ergon Corporation, 394 U.S. 477 (1935).

Claim 6 was deliberately broadly written by the patentee to cover all unitary power loaders and plaintiffs have, through Patent Office error, had the benefit since June 20, 1961 (the date of issuance of '196) of this improperly broad patent claim to the detriment and disadvantage of the public. Plaintiffs have not heretofore attempted to correct claim 6 by petitioning the Commissioner of Patents to narrow its scope. Instead, plaintiffs have taken advantage of the claim in notifying the public of their patent and in asserting it against defendant. Plaintiffs should not now be allowed to rewrite the claim to include new elements never intended to be included within the claim.

“Here claim I did not claim four wheels or rollers while other claims did. Other claims should not be read into claim 1.”

Stearns v. Tinker & Rasor, 252 F. 2d 589, 597 (C.A. 9, 1957).

“It appears to us that the limitation of claim 1 by the trial court to a tubular or enclosed guide is contrary to the well established rule of construction that a broad claim will not be construed to contain limitations expressed in the more narrow claims. *Smith v. Snow* (1935), 294 U.S. 1; *Stearns v. Tinker and Rasor*, (9th Cir. 1957), 252 F.2d 589; *Cameron Iron Works, Inc. v. Stekoll* (5th Cir. 1957) 242 F. 2d 17; *Great Lake Equipment Co. v. Fluid Systems, Inc.* (6th Cir. 1954), 217 F.2d 613.”

Hansen v. Colliver, 282 F. 2d 66 (C.A. 9, 1960).

Conclusion.

The District Court's conclusion of invalidity for the '196 patent was compelled by the prior state of the load lifter art, the testimony of the experts and the high standard of patentability applied by the courts. The admittedly lower standard applied by the Patent Office and its failure to consider the more pertinent prior unitary loader constructions before the District Court overcome any statutory presumption of validity. *Lugash '196* is merely an obvious adaptation of old unitary constructions of prior powered loaders in the old combination previously claimed in the '227 patent. There is no unexpected result. The progress of science is not promoted.

The District Court considered the asserted “clearance problem” of '196 and plaintiffs' allegation of a new result by a new combination, but correctly found to the contrary. It made no reversible error in fact or law. The '196 patent is invalid because the unitary or main

frame construction adopted by '196 was old in the art; there is no substantial difference in making powered loaders for vehicles unitary whether the load carrying platform folds down, out, up or over; '196 attempts to monopolize a combination of old elements which perform no new or unusual functions in combination; '196 claims the same old combination of elements claimed in the prior '227 patent with an obvious modification or alleged improvement in the main frame element; and because the '196 claims incorporate the claimed subject matter of '227 in combination with other disclosures of the prior art in a variant over '227 which is obvious to those skilled in the art.

Defendant was making powered loaders for vehicles long prior to plaintiffs and had adopted the prior well-known unitary construction for its loaders to allow ease of installation on vehicles, whether at defendant's plant or out in the field. Defendant's only modification of its admittedly old, prior art, non-patented construction of loader was to adopt the old folding platform concept of any of the Narvestad, Jester or Peters patents to facilitate dock loading. This prior folding concept to allow dock loading of powered truck loaders was part of the prior art freely available to those persons skilled in the art to adopt and use.

Defendant has the right to make use of prior art concepts and construction taught by prior patents whether they were ever in fact commercially used before or not. It cannot be held to infringe either of plaintiffs' patents which were issued by Patent Examiners who were unaware of the true state of the art and applied an admittedly low standard of invention. Defendant's prior art unitary truck loaders employing the

prior art folding platform cannot be held to infringe later conceived patents. The District Court's conclusion of invalidity as to the '196 patent should be affirmed.

C. A. MIKETTA,
WILLIAM POMS,
GUY PORTER SMITH,

of

MIKETTA, GLENNY, POMS &
SMITH,

Attorneys for Cross-Appellee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

GUY PORTER SMITH

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JESS H. NICHOLAS, JR., Appellant

v.

SECRETARY OF THE DEPARTMENT OF INTERIOR,
AND THE UNITED STATES OF AMERICA,

Appellee

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

SUPPLEMENTAL BRIEF FOR THE APPELLEE

FILED

EDWIN L. WEISL, JR.,
Assistant Attorney General.

DEC 2 1966

ROGER P. MARQUIS,
Attorney, Department of Justice,
Washington, D. C., 20530.

WM. E. LICK, CLERK

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 20667

JESS H. NICHOLAS, JR., Appellant

v.

SECRETARY OF THE DEPARTMENT OF INTERIOR,
AND THE UNITED STATES OF AMERICA,

Appellee

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ALASKA

SUPPLEMENTAL BRIEF FOR THE APPELLEE

This brief is filed pursuant to permission granted by order of October 21, 1966. Since appellee's brief was filed, the case of Coleman v. United States, 363 F.2d 190 (C.A. 9, 1966), heavily relied upon by appellant, was decided. In our petition for rehearing in that case, we outlined some of the respects in which we disagree with much of the reasoning of that decision. Similar language appears in Stewart v. Penny, 38 F.Supp. 821 (D. Nev. 1925). The attempted application of the language of Coleman to this case makes clear, we submit, its error.

- 2 -

A. The United States was an indispensable party which had not consented to this suit. - Appellant seeks a judgment "awarding to the Plaintiff the right to the public lands herein." In White v. Administrator of General Services Admin. of U. S., 343 F.2d 444 (C.A. 9, 1965), this Court said (p. 445):

The object of the appellants in the instant suit is to get the title out of the United States and into the appellants. A suit with such an objective is a suit for specific performance, regardless of what may be said in the complaint which initiates the suit. And, the title to the interest which the court is asked to order to be conveyed to the appellants being now in the United States, the order would have to be made against the United States. It follows that the United States would have to be a party to the suit.

Appellant's sole reference in the complaint as to jurisdiction was the Administrative Procedure Act, 5 U.S.C. sec. 1009. In White, supra, this Court said (p. 447): "We find nothing in the statutes relating to declaratory judgments or administrative procedure which is helpful to the appellants." "Still less is the [Administrative Procedure] Act to be deemed an implied waiver of all governmental immunity from suit." Blackmar v. Guerre, 342 U.S. 512, 515-516 (1952). "The Administrative Procedure Act, 5 U.S.C. § 1001 et seq., does not purport

to give consent to suits against the United States." Chournos v. United States, 335 F.2d 918, 919 (C.A. 10, 1964).

B. The broad review sought by appellant against the Secretary of the Interior was not available in the district court
Again relying on Coleman, appellant argues for a broad power of courts to supervise public land decisions of the Secretary of the Interior. Until 1962, only the courts of the District of Columbia had jurisdiction to review actions of the Secretary denying requested patents or other interests in the public domain. And that was a very narrow mandamus jurisdiction. That same narrow jurisdiction has now been extended to all district courts by 28 U.S.C. sec. 1361. "It is clear that the Act did not enlarge the scope of mandamus relief." Prairie Band of Pottawatomie Tribe of Indians v. Udall, 355 F.2d 364, 367 (C.A. 10, 1966); cf. White, supra. In Prairie Band, the court described the mandamus rule as follows (p. 367):

Historically, mandamus is an extraordinary remedial process awarded only in the exercise of sound judicial discretion. Before such a writ may issue, it must appear that the claim is clear and certain and the duty of the officer involved must be ministerial, plainly defined, and peremptory.

Huddleston v. Dwyer, 10 Cir., 145 F.2d 311. The duty sought to be exercised must be a positive command and so plainly prescribed as to be free from doubt. Wilbur v. United States ex rel. Kadrie, 281 U.S. 206, 50 S.Ct. 320, 74 L.Ed. 809.

Appellant can make no such showing here.

We submit that recent Supreme Court decisions in Boesche v. Udall, 373 U.S. 472 (1963), and Udall v. Tallman, 380 U.S. 1 (1965), answer the notion of Coleman that somehow the passage of the Administrative Procedure Act restricted the discretion in disposal of public domain which has existed since formation of the Union. Cf. White, supra, at p. 447, that it is not to be assumed there has been taken "such a revolutionary step on the part of Congress as the overturning of what had been settled law since the foundation of the Government, * * *."

Some fundamentals need restating. Congress has plenary power to control the disposition of the public domain. Alabama v. Texas, 347 U.S. 272, 273-274 (1954).

The determination of the validity of claims against the public lands was entrusted to the General Land-Office in 1812 (2 Stat. 716) and transferred to the Department of the Interior on its creation in 1849. 9 Stat. 395. Since that time, the Department has been granted plenary authority over the administration of public lands, including mineral lands;

and it has been given broad authority to issue regulations concerning them. Cameron v. United States, supra--an opinion written by Mr. Justice Van Devanter, who, as Assistant Attorney General for the Interior Department from 1897 to 1903, did more than any other person to give character and distinction to the administration of the public lands--illustrates the special role of the Department of the Interior in that field.

Best v. Humboldt Mining Co., 371 U.S. 334, 336-337 (1963).

The courts, especially the Supreme Court, have always been careful not to interfere with that "plenary authority over the administration of public lands" by undertaking broad "judicial review," i.e., supervision of that real estate disposal function. This history still prevails today and is the background against which the review authority of the courts is to be tested. The Coleman opinion mistakenly assumes that the court-Interior Department relations are similar to those between the courts and regulatory agencies formed mostly during the present century. We submit that, as stated in Best, the Cameron principle is good law today.

As to alleged estoppel, attention should be called to Beaver v. United States, 350 F.2d 4 (C.A. 9, 1965), cert. den., 383 U.S. 937.

For the foregoing reasons, it is respectfully submitted that the judgment of the district court should be affirmed.

EDWIN L. WEISL, JR.,
Assistant Attorney General.

ROGER P. MARQUIS,
Attorney, Department of Justice,
Washington, D. C., 20530.

DECEMBER 1966



No. 20667

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JESS H. NICHOLAS, JR.,)

Appellant)

vs)

SECRETARY OF THE DEPARTMENT)
OF INTERIOR, AND THE)
UNITED STATES OF AMERICA,)

Appellee.)
_____)

REPLY BRIEF OF APPELLANT

FISHER & HORNADAY
Box 397
Kenai, Alaska

Attorneys for Appellant

FILED

NOV 21 1965

WM. B. LUCK, CLERK

SUBJECT INDEX

	Page
I. Table of Authorities.....	ii
II. Summary of Argument.....	1
III. Argument.....	3
A. The Court erred in relying on the administrative decision as having a rational basis.....	3
B. The Court erred in not permitting the adminis- trative record to be amplified.....	3
C. The Court erred in failing to find the Secretary of the Department of the Interior abused his dis- cretion when he did not find that cultivation had been accomplished by the Appellant.....	3
1. Scope of judicial review of decisions of the Secretary of the Interior.....	3
2. Effect of decisions of the Secretary of the Interior.....	5
3. The record.....	6
4. Estoppel of the Department of the Interior..	8
5. Cultivation determination.....	10
D. The Court erred by not granting Appellant's prayer for equitable relief.....	11
IV. Certificate.....	13

I. Table of Authorities

Pages

Cases

<u>Coleman v. United States</u> , 263 F.2d 190 (9th Cir. 1966).. 6, 10, 12.	4, 5,
<u>Great Northern Ry. v. Reed</u> , 270 U.S. 537, 70 L.ed. 721 (1926).. 9	9
<u>Robertson v. Udall</u> , 349 F.2d 195.....	9
<u>Stewart v. Penny</u> , 238 F. Supp. 821 (D. Nev. 1965).....	5, 10, 11

Statutes

A.S. 22.15.120.....	9
---------------------	---

Land and Interior Decisions

<u>John Robert Claus, Richard H. Yoder</u> , 60 I.D. 457 (1951).. . . .	11.
<u>Walter H. Bullwinkle, Joseph E. Vogler</u> , 63 I.D. 179 (1956).....	11.
<u>Margaret L. Gilbert, Bob H. Oliphant</u> , 70 I.D. 128 (1963).....	10.
<u>John E. Tyrl</u> , 3 L.D. 49 (1884).....	10.

II. SUMMARY OF ARGUMENT

A. The Court erred in relying on the administrative decision as having a rational basis. Appellee has apparently waived objections to this contention.

B. The trial court erred in not permitting the administrative record to be amplified.

C. The court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant.

Appellant respectfully refers the Court to the SUMMARY OF ARGUMENT found on pages 10 - 11 of Brief of Appellant previously submitted.

1. Scope of judicial review of decisions of the Secretary of the Interior. Recent cases have invalidated the position of the Appellee on this point. Decisions of the Secretary of the Interior are not given special treatment under the Administrative Procedure Act.

2. Effect of decisions of the Secretary of the Interior. Recent cases have invalidated the position of the Appellees on this point.

3. The Record. This argument of the Appellee is contrary to the mandate of the United States Supreme Court

that a homesteader is entitled to a liberal interpretation of the homestead requirements. Most of the citations to which Appellee is objecting were requirements set out by the Department of the Interior or were statements made in front of the Solicitor of the Department of the Interior.

4. Estoppel of the Department of the Interior. The actions of the Department, taken in conjunction with the general rule that a homesteader is entitled to favored treatment, clearly establish an estoppel situation.

5. Cultivation Determination. Recent cases indicate that, in contrast to the position of the Appellee, the determination of Secretary as to adequate cultivation is not final.

D. The Court erred by not granting Appellant's prayer for equitable relief. Appellee has apparently waived objections to this contention. Appellant respectfully refers the Court to the Summary of this topic found on pages 11 - 12 of Brief of Appellant previously filed.

III. ARGUMENT

A. The Court erred in relying on the administrative decision as having a rational basis.

Appellee has made no effort to defend the "rational basis test" utilized by the trial court, nor has Appellee attempted to defend the decision of the Secretary as being rational. Accordingly, Appellant respectfully refers the Court to Pages 13 - 16 of Brief of Appellant for a comprehensive treatment of this topic.

B. The trial court erred in not permitting the administrative record to be amplified.

Homesteaders are entitled to a liberal interpretation. See citations throughout Brief of Appellant. Therefore, it is the position of the Appellant that the court erred by not permitting Appellant and others to give testimony.

C. The Court erred in failing to find the Secretary of the Department of the Interior abused his discretion when he did not find that cultivation had been accomplished by the Appellant.

1. Scope of judicial review of decisions of the Secretary of the Interior.

The argument of the Appellee on this point is merely legalistic and in complete disregard of the favored



treatment to which a homesteader is entitled. As is further discussed in 2. and 5. below, the courts are now protecting homesteaders from inequitable treatment by the Department of the Interior.

In essence, Appellee is arguing that decisions of the Secretary of the Interior are entitled to special treatment when brought before a court for judicial review. The same argument was made by the Department and rejected in Coleman v. United States, 363 F.2d 190 (9th Cir. 1966).

This very court replied:

At the outset, we are faced with contentions by the Government seeking to limit the scope of judicial review of decisions in the Department of the Interior. This campaign commenced some years back when first it was broadly contended that the Administrative Procedure Act does not apply to Decisions of the Secretary of the Interior. This Court had no difficulty in rejecting this contention. . . . Next, as in this case the Secretary has argued that the determination of a question of fact by the Secretary of Interior, or his authorized representative, is conclusive in the absence of fraud or imposition" and that "decisions of the Secretary of Interior with respect to public lands have historically been accorded a conclusiveness beyond that of typical regulatory agencies." These are not the standards for review provided in the Administrative Procedure Act. Page 194

Our study of . . . decisions and others has not persuaded us that Congress intended decisions of the Department of the Interior which reject application for patent to enjoy a more favored

position than those of other executive agencies under the Administrative Procedure Act. Page 195.
(Emphasis supplied)

The issues, then, which faced the District Court are those provided in the Administrative Procedure Act. Were the "agency action, findings, and conclusions * * * arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," or "unsupported by substantial evidence? 5. U.S.C. §1009(e)(B)(1)(5). Page 196. See also Stewart v. Penny, 238 F. Supp. 821, 827 (D. Nevada 1965)

2. Effect of decisions of the Secretary of the Interior

Appellee contends that decisions of the Secretary

of the Interior are binding upon a reviewing court in the absence of a showing that the Secretary's decision is Clearly erroneous.

The Brief of Appellant satisfactorily establishes that the decision of the Secretary was "clearly erroneous."

Eventhough Appellant has shown that the decisions of the Secretary was "clearly erroneous", it should be pointed out that Appellee is applying an incorrect standard. Decisions of the Secretary of the Interior are not entitled to special consideration under the Administrative Procedure Act. As set forth by this court, a decision of the Secretary will be overturned where it is arbitrary, capricious, and abuse of discretion, not in accordance with law or unsupported by substantial evidence. United States v. Coleman, supra.

Under any of these tests, the decisions of the Secretary cannot

stand as is explained in the Brief of Appellant.

3. The Record

Appellee has objected to the consideration by the Court of certain authorities cited by Appellant. The inclusion of this argument in Appellee's Brief is an indication of the weakness of the over-all position of the Appellee. Homesteaders are favored in the law. See citations throughout Brief of Appellant. However, for some reason, Appellee refuses to accept the mandate of the United States Supreme Court on this question. This Court has considered the type of evidence to which Appellee objects. Coleman v. United States, supra, at page 197.

The affidavits were made by a homesteader with first hand knowledge of the facts therein. The Department of the Interior changed positions on the Appellant. Brief of Appellant, Page 15. The requirements of the Department are "fantastically complex." Brief of Appellant, page 34. This Court is aware of the bewildering aspects of these requirements and has protected a claimant from unfair treatment by the Department. United States v. Coleman, supra, at Page 203. Moreover, these affidavits were apparently admitted before the District Court, or at least there was no ruling, to the knowledge of the undersigned, which kept the affidavits out of the

record. Therefore, if Appellee opposed the consideration of the affidavits by this Court, Appellee should have filed a Notice of Appeal.

Appellee has objected to citations from Senate Committee Hearings. The hearings concerned legislation which Senator Ernest Gruening of Alaska introduced in the Senate. The statements were made in front of Mr. Frank J. Barry, Solicitor for the Department of the Interior. Therefore, the agency was aware of the statements. Mr. Barry is the superior of the gentleman who wrote the Secretary's Decision which is at issue.

The objection by Appellee to consideration of the publications set forth in the Record at pages 58-77 is incredible. It is beyond the pale of imagination how an agency could argue it was not aware of the very requirements set forth by that agency. These publications are distributed to the general public and are titled:

Department of the Interior
Bureau of Land Management
HOMESTEADING IN ALASKA

The newspaper article concerned hearings before the Public Land Review Commission established by the 88th Congress. This Commission was set up to review the administration of public land laws and recommend improvements to Congress. The

statements cited were made by Howard Pollack, now Congressman Howard Pollack.

Accordingly, all of the citations should be considered by the Court. Each citation indicates that the argument of the Appellee is without foundation.

4. Estoppel of the Department of the Interior.

The Department is applying stricter requirements to Appellant than have been applied to other homestead applicants. Further, the Department changed positions. The Secretary concedes that there is no fixed standard of cultivation. (R-6) At the time Appellant was proving up, the Department publications did not emphasize the methods of cultivation. R-62). However, subsequent publications set out cultivation requirements in more detail. These subsequent publications should not be controlling as they were not in effect at the time of proving up. Brief of Appellant, pages 14-6 and 20-22.

Appellant explained that Department employees informed him that clearing alone was sufficient and further that he traveled to the Anchorage office when he was unable to rent a tractor. Due to the fault of the Department, the office was understaffed. After waiting for a considerable length of time in a room crowded with oil speculators, Appellant was informed by a Department employee that an exception on cultivation could

be granted at the time of final proof. This is in accord even with the retroactive and inappropriate requirements Appellee is attempting to apply. (R-72)

Appellee's statement that Appellant is a District Court Judge is incorrect. Appellant is a Deputy Magistrate (title has recently been changed to Magistrate). The jurisdiction of a magistrate is limited to cases \$500.00 and below and to misdemeanors. AS 22.15.120, as amended. Appellant's jurisdiction is similar to a Justice of the Peace outside. Moreover, Appellant was not serving in this capacity while he was proving up.

Appellee relies heavily on Great Northern Railway Co. v Reed, 270 U.S. 539. However, it is clear that Reed only requires substantial compliance which Appellant has satisfied. Brief for Appellee, Page 18. See also citations to the effect that a good faith effort is satisfactory on pages 21-24 and 36 of Brief of Appellant. Citations set forth in the Brief of the Appellant also establish that there is flexibility in interpreting homestead requirements.

Appellee is attempting to enforce a high standard of cultivation when it is admitted there is no such standard. This approach removes Appellee from any assistance of Robertson v Udall, page 20, Brief for Appellee, as that case requires a

decision of the Secretary to be within the bounds of reason.

5. Cultivation determination.

Appellee continues to argue that decisions of the Secretary are entitled to special consideration. This approach was rejected by this Court in Coleman v. United States, supra. Likewise, in Coleman a determination of the word valuable was overturned. This argument was rejected in Stewart v. Penny, 238 F. Supp. 821 (D. Nev. 1965). This case is set forth at length on pages 18-19 and 26-30 of Brief of Appellant.

Appellee sets out a definition of cultivation on page 24 of Brief for Appellee. It must be pointed out that the Secretary has held that clearing one-half acre of land qualifies under basically the same definition relied upon by the Appellee. John E. Tyrl, 3 L.D. 49 (1884). See Brief of Appellant, pages 22-3.

Margaret L. Gilbert v. Bob H. Oliphant, 70 I.D. 128 (1963) is not applicable to this proceeding because it was not in effect at the time Appellant was proving up. Further, Oliphant is distinguishable in that there was no attempt to explain his failure to comply. In the instant situation, Appellant has explained over and over again that he could not obtain a tractor. Further, he was informed by the Department that clearing alone was sufficient and that he could make an

application for relief at the time of final proof. (R-23-4)

Appellee contends that the non-standard of cultivation which it is attempting to enforce has been in effect for forty years and that the Department has never varied therefrom because no discretion is permitted. This is hardly the case. In two decisions dealing with Alaska, the Secretary has indicated that estoppel may be permissible against the Department and that there is discretion as to cultivation. See John Robert Claus, Richard H. Yoder, 60 I.D. 457 (1951) and Walter H. Bullwinkle, Joseph E. Vogler, 63 I.D. 179 (1956). See citations set forth throughout Brief of Appellant to the effect that discretion is permitted as to cultivation.

It is the position of the Appellant that he has satisfied the cultivation requirements. Taking into consideration the obstacles of nature and environment with which Appellant had to contend, the planting of rye was sufficient and Appellant's efforts at cultivation qualify as a process of cultivation. Stewart v. Penny, page 29, Brief of Appellant.

D. The Court erred by not granting Appellant's Prayer for equitable relief.

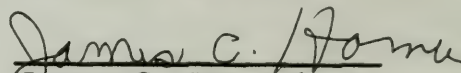
In addition to the coverage of this point found at pages 33-37 of Brief of Appellant, Appellant respectfully presents a quotation from this Court.

It has long been established that a qualified entryman upon public lands of the United States, whether as a locator of a mining claim, as a homesteader, or as one asserting rights under others of the multifarious laws governing entries on public lands, who perfects his entry by compliance with the applicable Act of Congress, thereby acquires a right to the land as against the sovereign itself, as well as against third persons . . . It is such a legal right which Appellant here seeks to assert and its not a right which the Secretary of the Interior may, in his discretion, ignore or which he may reject "in the absence of fraud or imposition." This is precisely the kind of right which the Administrative Procedure Act, with its provisions for judicial review, was designed to safeguard from arbitrary, capricious and illegal deprivation by action of executive and administrative agencies. Coleman v United States, 363 F. 2d 190, 196 (9th Cir. 1966). (Emphasis supplied)

IV. Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

FISHER & HORNADAY


James C. Hornaday

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ROBERT E. McCARTHY, Successor to WALTER E. BECK,
as Manager of the United States Land Office at
Sacramento, California,

Appellant

v.

LEONARD E. NOREN AND HARRY C. PERRY,

Appellees

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA,
NORTHERN DIVISION

BRIEF FOR THE APPELLANT

EDWIN L. WEISL, JR.,
Assistant Attorney General.

MANUEL L. REAL,
United States Attorney,
Los Angeles, California, 90012.

RICHARD J. DAUBER,
Assistant United States Attorney,
Los Angeles, California, 90012.

WM. B. LUCK, CLERK
ROGER P. MARQUIS,
GEORGE R. HYDE,
Attorneys, Department of Justice,
Washington, D. C., 20530.

FILED

JUN 28 1966

I N D E X

	Page
Opinion below-----	1
Jurisdiction-----	2
Questions presented-----	2
Statutes involved-----	3
Statement-----	5
Summary of argument-----	12
Argument:	
Introduction-----	14
I. Adversary hearings are not required for the classification of lands under the Taylor Grazing Act-----	16
A. Congress has given the Secretary of the Interior the discretion to classify for dis- posal or retention the public lands of the United States-----	16
B. The Secretary has exclusive jurisdiction to classify the public lands of the United States-----	23
C. The Department of the Interior's interpreta- tion and consistent application of a statute are entitled to great deference-----	30
D. The district court has erroneously assumed that the filing of an application to enter public lands has given the applicant a prop- erty right-----	33
II. In any event, it does not appear that the lack of adversary hearing in the first instance prejudiced appellees-----	35
III. The earlier judgment was <u>res adjudicata</u> -----	38
Conclusion-----	45
Appendix:	
Complaint-----	46
Memorandum and order, filed March 8, 1963-----	54

Cases:

<u>Annat v. United States</u> , 277 F.2d 554-----	43
<u>Best v. Humboldt Mining Co.</u> , 371 U.S. 334-----	26, 28, 35
<u>Boesche v. Udall</u> , 373 U.S. 472-----	28, 35, 37
<u>Brooks v. Dewar</u> , 313 U.S. 354-----	32
<u>Brown v. Hitchcock</u> , 173 U.S. 473-----	27, 28
<u>Cameron v. United States</u> , 252 U.S. 450-----	26, 35
<u>Carl v. Udall</u> , 309 F.2d 653-----	17
<u>Dredge Corporation, The v. Penny</u> (C.A. 9, No. 19964)-----	36
<u>Ferry v. Udall</u> , 336 F.2d 706-----	29
<u>Gibson v. Chouteau</u> , 13 Wall. 92-----	23
<u>Haley v. Seaton</u> , 281 F.2d 620-----	37
<u>Hatchitt v. United States</u> , 158 F.2d 754-----	39
<u>Jay v. Boyd</u> , 351 U.S. 345-----	27
<u>Knauff v. Shaughnessy</u> , 338 U.S. 537-----	27
<u>LaRue v. Udall</u> , 324 F.2d 428, cert. den., 376 U.S. 907-----	(30, 32) (34, 36)
<u>Myers v. Gardner</u> (C.A. 9, No. 20282)-----	44
<u>Shaughnessy v. Mezei</u> , 345 U.S. 206-----	27
<u>Southwestern Petroleum Corp. v. Udall</u> (C.A. 10, No. 8250)-----	36
<u>Standard Oil Co. of California v. United States</u> , 107 F.2d 402, cert. den., 309 U.S. 654-----	28
<u>Stark v. Starr</u> , 94 U.S. 477-----	42
<u>Udall v. Tallman</u> , 380 U.S. 1-----	31, 32
<u>United States v. Jackson</u> , 280 U.S. 183-----	32
<u>United States v. Mackintosh</u> , 85 Fed. 333-----	30
<u>United States v. Nugent</u> , 346 U.S. 1-----	27
<u>United States v. Throckmorton</u> , 98 U.S. 61-----	44
<u>United States ex rel. Alaska Smokeless Coal Co. v. Lane</u> , 250 U.S. 549-----	28
<u>United States ex rel. Hall v. Payne</u> , 254 U.S. 343-----	27
<u>United States ex rel. McBride v. Schurz</u> , 102 U.S. 378-----	27
<u>United States ex rel. Riverside Oil Co. v. Hitchcock</u> , 190 U.S. 316-----	27
<u>Williamson v. Columbia Gas & Electric Corp.</u> , 186 F.2d 464-----	42

Constitution, statutes and regulation:

U. S. Constitution:

Article IV, Section 3-----	23
Fifth Amendment-----	34, 38, 43
Section 7 of the Taylor Grazing Act of June 28, 1934, 48 Stat. 1269, 1272, as amended by	(14, 15,
Section 2 of the Act of June 26, 1936, 49	(17, 18,
Stat. 1976, 43 U.S.C. sec. 315f-----	(20, 24, 25
R.S. sec. 441-----	25
R.S. sec. 453-----	25
R.S. sec. 2478-----	26
5 U.S.C. sec. 485-----	25
43 U.S.C. sec. 2-----	25
43 U.S.C. sec. 1201-----	26
43 C.F.R. sec. 296.1(a)(1)-----	22

Interior Department decisions:

<u>Lewis Lafon Gourley</u> , A-38497-----	31
<u>Raymond L. Gunderson</u> , 71 I.D. 477-----	31
<u>Joseph E. Hatch</u> , 55 I.D. 580-----	31

Miscellaneous:

Annual Report of the Secretary of the Interior, 1958 edition-----	15
Executive Order No. 6910-----	24, 25
Hearings before the House Committee on Public Lands, 73d Cong., 1st sess., on H.R. 2835----	18
Hearings before the House Committee on Public Lands, 73d Cong., 2d sess., on H.R. 6462----	18
Hearings before the Senate Committee on Public Lands and Surveys, 74th Cong., 1st sess., on S. 2539-----	20

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20671

ROBERT E. McCARTHY, Successor to WALTER E. BECK,
as Manager of the United States Land Office at
Sacramento, California,

Appellant

v.

LEONARD E. NOREN AND HARRY C. PERRY,

Appellees

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA,
NORTHERN DIVISION

BRIEF FOR THE APPELLANT

OPINION BELOW

The district court's unreported memorandum opinion
and order are set out at pages 152-154 of the record.

JURISDICTION

Jurisdiction was invoked by the appellees against appellant purportedly under the Fifth Amendment of the Constitution of the United States and the Act of March 3, 1877, 19 Stat. 377, as amended, 43 U.S.C. sec. 321, and the Act of June 28, 1934, 48 Stat. 1272, as amended, 43 U.S.C. sec. 315f (the Taylor Grazing Act). Although not specifically invoked, apparently the district court took jurisdiction under the Act of October 5, 1962, 76 Stat. 744, 28 U.S.C. secs. 1361, 1391(e). Judgment of the district court for appellees was entered on September 17, 1965 (R. 155). Notice of appeal was filed on November 15, 1965 (R. 162). This Court's jurisdiction rests on 28 U.S.C. sec. 1291.

QUESTIONS PRESENTED

1. Whether the district court erred in holding that due process requires that the Department of the Interior must hold an adversary type hearing when public lands are being classified in response to an application filed under the Desert Land Act (43 U.S.C. sec. 321 et seq.).

2. Whether the district court erred in holding the Secretary of the Interior's rejection of the appellees' application to enter land under the Desert Land Act was capricious and arbitrary.

3. Whether the district court erred in not granting appellant's motions to dismiss on the ground of res judicata.

STATUTES INVOLVED

43 U.S.C. sec. 315f provides:

The Secretary of the Interior is authorized, in his discretion, to examine and classify any lands withdrawn or reserved by Executive order of November 26, 1934 (numbered 6910), and amendments thereto, and Executive order of February 5, 1935 (numbered 6964), or within a grazing district, which are more valuable or suitable for the production of agricultural crops than for the production of native grasses and forage plants, or more valuable or suitable for any other use than for the use provided for under this chapter, or proper for acquisition in satisfaction of any outstanding lien, exchange or script rights or land grant, and to open such lands to entry, selection, or location for disposal in accordance with such classification under applicable public-land laws, except that homestead entries shall not be allowed for tracts exceeding three hundred and twenty acres in area. Such lands shall not be subject to disposition, settlement, or occupation until after the same

have been classified and opened to entry: Provided, That locations and entries under the mining laws including sections 181-184, 185-188, 189-194, 201, 202-209, 211-214, 223, 224-226, 226-2, 227-229a, 241, 251, and 261-263 of Title 30, may be made upon such withdrawn and reserved areas without regard to classification and without restrictions or limitation by any provision of this chapter. Where such lands are located within grazing districts reasonable notice shall be given by the Secretary of the Interior to any grazing permittee of such lands. The applicant, after his entry, selection, or location is allowed, shall be entitled to the possession and use of such lands: Provided, That upon the application of any applicant qualified to make entry, selection, or location, under the public-land laws, filed in the land office of the proper district, the Secretary of the Interior shall cause any tract to be classified, and such application, if allowed by the Secretary of the Interior, shall entitle the applicant to a preference right to enter, select, or locate such lands if opened to entry as herein provided. (June 28, 1934, ch. 865, § 7, 48 Stat. 1272; June 26, 1936, ch. 842, title I, § 2, 49 Stat. 1976.)

43 U.S.C. sec. 322 provides:

All lands exclusive of timber lands and mineral lands which will not, without irrigation, produce some agricultural crop, shall be deemed desert lands, within the meaning of sections 321-323, 325 and 327-329 of this title, which fact shall be ascertained by proof of two or more credible witnesses under oath, whose affidavits shall be filed in the land office in which said tract of land may be situated.

The determination of what may be considered desert land shall be subject to the decision and regulation of the Secretary of the Interior or such officer as he may designate. (Mar. 3, 1877, ch. 107, §§ 2, 3, 19 Stat. 377; 1946 Reorg. Plan No. 3, § 403, eff. July 16, 1946, 11 F. R. 7876, 60 Stat. 1100.)

STATEMENT

This action was instituted by the appellees, Noren and Perry, seeking to enjoin the Manager of the Sacramento Land Office and the State Supervisor of the Bureau of Land Management, California, from taking any further adverse administrative action with respect to their application to enter certain desert lands. Appellees also sought to compel the appellant to reinstate their desert land applications, to allow the same and to permit them to enter the lands embraced within their respective applications (R. 6).

The sequence of events leading to this action is as follows: The appellees herein filed desert land entry applications in the Sacramento Land Office on November 26, 1951, and January 3, 1952 (R. 173). The Manager of the Sacramento Land Office, by decision dated January 9, 1953, rejected both applications on the ground that a field report on the tracts of land sought to be entered showed that the soil was unsuitable for agricultural development due to an extremely high accumulation of salt. The appellees herein appealed this rejection of their applications to the Director of the Bureau of Land Management, alleging that the decision was arbitrary, capricious and a fraud on the Desert Land Act and that the Manager had relied on a record which they were not permitted to see, so that their rights were denied without a hearing on the facts. The Director of the Bureau of Land Management affirmed the decision of the Land Office Manager on November 24, 1954, pointing out that the determination of what is desert land is subject to the decision and regulation of the Secretary of the Interior or his designee, citing 43 U.S.C. sec. 322. The Director also pointed

out that the land in the entries was withdrawn from settlement, location, sale or entry and that the Secretary of the Interior is authorized by Section 7 of the Taylor Grazing Act, as amended (43 U.S.C., 1952 ed., sec. 315f), in his discretion, to examine and classify such withdrawn land and, when he finds that the land is more valuable or suitable for other purposes than for the production of forage, to restore such land to entry.

The appellees appealed from the adverse decision to the Secretary of the Interior. By decision dated August 1, 1955 (R. 168, 169), the Secretary noted that two desert land entries had been allowed within one to three miles of the subject tracts. The Secretary, as a result of the allowance of the nearby entries, remanded both cases to the Land Office, with instructions to allow the appellees a reasonable time to submit whatever evidence they desired to disprove the classification of the lands applied for as being unsuitable for agricultural development. As a result of this remand, the appellees and the Bureau of Land Management individually

conducted additional studies with respect to the controverted lands. The records of both examinations were then resubmitted to the Director's office, which then issued a decision dated September 25, 1957. This decision again affirmed the rejection of the desert land applications, after having given consideration to the applicants' evidence and an extensive discussion of the problems raised by salt concentrations on the land.

The appellees took an appeal from the Director's decision to the Secretary, protesting that they had not been shown the report of the Bureau's re-examination of the land before the decision was written, disputing the conclusions and decrying the inconclusive role assigned to the photographs submitted by them. The Secretary, by decision dated September 13, 1960 (R. 172), considered in detail what were termed by the appellees to be five erroneous assumptions (R. 175-183) and concluded that they, in fact, were not erroneous (R. 183). The Secretary in his decision concluded that the appellees herein had "not submitted any evidence which proves that the admitted saline character of the soil can be altered so that the land will become suitable for agricultural production by

economical and feasible methods. In the absence of convincing evidence, which the appellants have not furnished, I am unable to suppose that land of very high salinity and low permeability which will prevent economically feasible crop production is improperly classified as unsuitable for desert land entry" (R. 183-184).

The appellees thereafter instituted an action against the local officials of the Bureau of Land Management in the United States District Court for the Southern District of California, Civil No. 2139 N.D. The adverse classification of the subject lands by the Secretary was contended to be arbitrary and unlawful. A trial de novo on the facts was asked for and denied. Noren v. Beck, 199 F.Supp. 708 (Nov. 21, 1961). Judge Crocker in his opinion held that any review of this matter was to be restricted to a review of the administrative record. The court also stated at page 710 of its published opinion that "The plaintiffs' argument that the agency did not hold a formal hearing where witnesses could testify and be cross-examined is answered by the Desert Land Entries Act, 43 U.S.C.A. § 321 et seq., which does not

require such a hearing * * *." The appellees herein took no appeal from this decision. Upon review of the administrative record, Judge Crocker entered a final judgment dated March 8, 1963, which stated "after a careful review I find that the administrative decision and the findings upon which it is based are abundantly supported by the evidence appearing in the record." Accordingly, the district court affirmed the Secretary's decision of September 13, 1960.^{1/}

Pending the first case, appellees filed a second complaint. In response to this complaint which the appellees filed (R. 2), a motion to dismiss was made, based on the ground that it was the same cause of action as was already before the district court (R. 14). The district judge, by order filed April 8, 1963 (R. 29), denied the motion, ruling that the "complaint states a different claim than that litigated in Case No. 2139-ND." A second motion to dismiss (R. 32) was filed after the time for appeal from the first cause of action had expired. The reasons given in support of the

^{1/} The complaint, opinion and final judgment in this case are printed in the Appendix.

second motion to dismiss were that the complaint failed to state a claim against the defendant upon which relief can be granted, since the matter is res adjudicata; that the court lacks jurisdiction, since the action is in effect against the United States, which has not consented to be sued; and that the plaintiffs have failed to join an indispensable party.

The district judge, by order filed August 12, 1964 (R. 94), denied the Government's motion to dismiss, stating that "The complaint herein states a cause of action based upon a claim of denial of due process guaranteed by the fifth [sic] Amendment of the United States Constitution" (R. 94) and that "This cause of action was not litigated in the previous case of Noren v. Beck, 199 F.Supp. 708, as it had been in Adams v. Witmer, 271 F.2d 29, so the doctrine of res judicata does not apply. The other grounds stated in the motion to dismiss are without merit" (R. 94-95).

The district court, by letter dated November 10, 1964, advised the litigants that the sole issue to be decided by the court was whether the administrative proceedings were conducted in such a way as to deprive the appellees of due process of law.

11

A memorandum and order were entered by the district court on July 1, 1965 (R. 152), holding that the agency action rejecting the desert land applications was "capricious and arbitrary" and constituted a denial of due process of law. The district court then remanded this matter to the administrative agency for further hearings consistent with its opinion (R. 154, 156). This appeal followed.

Appellees moved to dismiss the appeal on the ground that the judgment was not final and appealable. This was denied by order of this Court of February 9, 1966.

SUMMARY OF ARGUMENT

The decision of the district court reverses 29 years of administrative construction of a section of the Taylor Grazing Act and has the effect of imposing a burden of staggering proportions on the Department of the Interior. The requirement that an adversary hearing be held by the Department of the Interior prior to a discretionary action being taken is clearly contrary to the intent of Congress.

A. The Secretary of the Interior has been given the discretion to classify for disposal or retention the public lands of the United States. The statute and legislative

history clearly show that Congress has vested the Secretary of the Interior with the discretion to classify public lands.

There are no rights to property involved in a classification proceeding. The only right present in this case was to have land classified, which was done. It was never intended by Congress that a judicial review would be made of a classification matter.

B. The exclusive jurisdiction to classify public land has been vested in the Secretary of the Interior. The classification made here is not in any sense arbitrary or capricious. The authority of the Secretary of the Interior is that of a special tribunal for the supervision and disposal of public lands. The judicial power of the United States does not extend to the disposal of public lands. This Court lacks the power to review the Secretary's exercise of discretion.

C. The Department of the Interior's interpretation and consistent application of a statute are entitled to great deference.

D. No rights to land are obtained by the filing of an application to enter public lands.

II

The lack of an adversary type hearing has not prejudiced the appellees, in that they have been permitted to introduce all their evidence and to have it fully considered. The procedure followed in this case is not unique and has clearly been recognized by Congress as a means of properly disposing of public lands.

III

This matter is clearly res judicata, since both complaints are identical in the relief asked for. The only new element introduced in the second complaint was a legal argument based on an alleged violation of due process.

ARGUMENT

Introduction: The decision of the district court, if permitted to stand, reverses 29 years of administrative construction of one of the most important sections of the Taylor Grazing Act, 43 U.S.C. sec. 315f. The district court's decision would have the effect of requiring a major change in the procedure consistently followed by the Department of the Interior in the classification for retention or disposal of public lands belonging to the United States. The magnitude

- 15 -

of the problem can be seen by an examination of the tables in the Annual Report of the Secretary of the Interior, 1958 edition, p. 252, where a breakdown of classification and investigation operations before the Bureau of Land Management during the fiscal year 1958 is given. That report shows that, at the beginning of that year, 24,670 cases were pending classification and investigation. During the year, 17,101 new cases were received and 20,368 cases were closed, leaving pending, at the end of the year, 21,403. The district court's decision, if permitted to stand, would require that an administrative hearing be held in each classification action taken pursuant to 43 U.S.C. sec. 315f. Aside from the fact that this would impose a burden of staggering proportions on the Department of the Interior, this requirement clearly is contrary to the intent of Congress and the clear statutory language contained in the Taylor Grazing Act. Because of the importance of this question to the administrators of the public lands, we address ourselves primarily to it, even though we think in fact there has been no substantial violation of due process principles.

I

ADVERSARY HEARINGS ARE NOT REQUIRED
FOR THE CLASSIFICATION OF LANDS
UNDER THE TAYLOR GRAZING ACT

A. Congress has given the Secretary of the Interior the discretion to classify for disposal or retention the public lands of the United States. - "The Secretary of the Interior is authorized, in his discretion, to examine and classify any lands withdrawn or reserved * * *, or within a grazing district which are more valuable or suitable for the production of agricultural crops than for the production of native grasses and forage plants, or more valuable or suitable for any other use than for the use provided for under this chapter, * * *, and to open such lands to entry, selection, or location for disposal in accordance with such classification under applicable public-land laws, * * *. Such lands shall not be subject to disposition, settlement, or occupation until after the same have been classified and opened to entry: * * *. The applicant, after his entry, selection, or location is allowed, shall be entitled to the possession and use of such lands:

Provided, That upon the application of any applicant qualified to make entry, selection, or location, under the public-land laws, filed in the land office of the proper district, the Secretary of the Interior shall cause any tract to be classified, and such application, if allowed by the Secretary of the Interior, shall entitle the applicant to a preference right to enter, select, or locate such lands if opened to entry as herein provided." 43 U.S.C. sec. 315f. (Emphasis supplied.)

This section of the Taylor Grazing Act clearly authorizes the Secretary, in his discretion, to classify for disposal or retention the public lands of the United States. Carl v. Udall, 309 F.2d 653, 657 (C.A. D.C. 1962). It should be noted that, when the Secretary of the Interior was originally given the discretion to classify the public lands of the United States, no provision was made to compel him to take any classification action. And, of course, there are no private rights of any kind in the land, at least until after favorable classification.

The original delegation by Congress of discretion to the Secretary of the Interior was reaffirmed by the amendment to the Taylor Grazing Act dated June 26, 1936, c. 842,

Title I, sec. 2, 49 Stat. 1976, which added the requirement that the Secretary (1) in response to a qualified application shall "cause any tract to be classified," and (2) provided that "such application, if allowed by the Secretary of the Interior, shall entitle the applicant to a preference right to enter, * * * if opened to entry as herein provided." The Act laid down no requirements as to the procedure to be followed by the Secretary in making classifications.

The question whether too much discretion was being given the Secretary of the Interior in the Taylor Grazing Act was clearly of concern to the drafters of that Act. In hearings, prior to passage of that Act, before the House Committee on Public Lands, 73d Cong., 1st sess., on H.R. 2835, and 73d Cong., 2d sess., on H.R. 6462, February 23, 1934, at pages 138-139 of the hearings, this concern is concisely stated and recognized:

Mr. ENGLEBRIGHT. May I make another suggestion, since the Secretary is here: One objection most frequently heard in the meetings of this committee on this bill is that the bill would give too wide a discretionary jurisdiction over the public domain to the Secretary of the Interior.

That objection was made in general here, and I think it is the feeling on the part of a considerable number of the members of the committee. I believe it would be valuable if the committee heard the Secretary's views on that point.

Secretary ICKES. Somebody, in my judgment, has to have this authority. If the Secretary of the Interior's record and his views on public questions is such that he cannot be intrusted with the authority, give it to somebody else, but if you will pardon a self-serving statement, I am prepared to say that so far as power lies in me, I would try to administer the law, if intrusted with this power, to the best interests of all concerned.

Mr. ENGLEBRIGHT. I am sure, Mr. Secretary, we would not offer the objection on that ground. It is not the intention of any member of the committee to object to this discretion being lodged in yourself. The objection was to the lodging of this discretionary jurisdiction over the public domain in any bureau. That was the objection.

Secretary ICKES. As it is now, your range is being destroyed. Somebody has to be entrusted to administer it for the best good of all concerned. I think it is absolutely necessary to do it in the public interest.

The CHAIRMAN. I think without that clause in there the bill would be meaningless.

Secretary ICKES. It would not mean a thing.

In Hearings before the Committee on Public Lands and Surveys, United States Senate, 74th Cong., 1st sess., on S. 2539, a bill to amend the "Taylor Grazing Act," which resulted in the passage of 49 Stat. 1976, the recognition of the discretionary authority which had been given the Secretary by Congress in enacting the Taylor Grazing Act is also discussed. It is stated at page 8 of the Hearings held on May 15, 1935, that:

Senator O'MAHONEY. Under the law as it now stands and under the amendment as it has been presented here, the Secretary is authorized in his discretion to examine and classify.

Mr. PAGE. That is true.

Senator O'MAHONEY. Would you think that it would be advisable to make it mandatory upon the part of the Secretary to make this reclassification?

Mr. PAGE. No; I do not think so. The history of public-land legislation of the last several years has been to include that term in nearly all acts. And I do not think it is advisable to depart from it. In other words, the Secretary uses his discretion properly, and I think the Secretary should be given the discretion. In other words, you will make an application under this provision and it will have to be examined. If the proper

showing is made, just the same as for a great many entries under other laws of recent years, and if everything is found to be proper, the Secretary will use his discretion properly to allow that entry.

Senator O'MAHONEY. That is not what I have in mind. Of course the discretion of the Secretary to allow an entry or to reject it ought to be preserved. That is the whole history of the development of the public-land law, that the Secretary passes upon all applications. The thought in my mind is whether it would be advisable to make the classification mandatory.

Senator HAYDEN. I can say, Senator O'Mahoney, that classification was quite thoroughly discussed at the time of the enactment of the 640-acre homestead law. You will remember that at that time Congressman Kent, of California, was very active in that respect. I was a member of the Public Lands Committee of the House of Representatives at the time, and there was quite strong sentiment to direct a classification of all public lands. Two objections were raised: First, that if Congress made it mandatory that it be done, then funds would have to be provided to do the work, and no one knew when we would get the appropriations from the Treasury to make the classification, and, second, that pending the completion of a mandatory classification everything would be tied up. So, the committee finally concluded that the best way to proceed was that as the occasion arose a classification might be made.

The court here has directed that an adversary type of hearing be held by the Department of the Interior. This is a complete departure from the history of public administration since the founding of the country. There are a myriad of matters in which the Secretary has been vested with discretion to determine. Historically, almost none of these have been the subject of adversary type hearings with presentation of witnesses pro and con with respect to a contemplated action, subject to cross-examination, etc. This simply was never intended by Congress as to the Taylor Grazing Act in this particular or any other public land statute which is silent on this subject. No rights are involved in this type of classification proceeding. Congress was simply disposing of its bounty when it established the manner in which the public lands are to be obtained by citizens of this country. No rights exist to have lands favorably classified. Another evidence of the fact that Congress never envisaged an adversary type proceeding is the provision in the statute that the Secretary may examine and classify any lands withdrawn without any application for the lands having been filed.^{2/} The fact that Congress provided

^{2/} The pertinent regulations are contained in 43 C.F.R. sec. 296.1(a)(1).

for ex parte classification of lands by the Secretary reinforces the position that this is simply a matter of discretion in the course of the largest real estate management program in the country. The fact that the classification was in response to an application does not in any way change the standard applied. In fact, since the Secretary may classify lands on an ex parte basis, it is obvious that Congress never intended for a judicial review to be made of his classification. The only relief from an unfavorable classification would be from the Congress which gave the discretion to the Secretary.

B. The Secretary has exclusive jurisdiction to classify the public lands of the United States. - Article IV, Section 3, of the Constitution vests in Congress the "Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States." "That power is subject to no limitations. Congress has the absolute right to prescribe the times, the conditions, and the mode of transferring this property, or any part of it, * * *." Gibson v. Chouteau, 13 Wall. 92, 99

(1871). In Section 7 of the Taylor Grazing Act, June 28, 1934, 48 Stat. 1269, 1272, as amended by Section 2 of the Act of June 26, 1936, 49 Stat. 1976, 43 U.S.C. sec. 315f, Congress authorized the Secretary of the Interior, "in his discretion, to examine and classify any lands withdrawn or reserved" by Executive Order No. 6910, which embraces the land involved here, and it further specified: "Such lands shall not be subject to disposition, settlement, or occupation until after the same have been classified and opened to entry." When appellees filed their Desert Land applications in these cases, the Secretary, by his delegated representatives, examined the lands and classified them, but he classified them as unsuitable for agricultural development and rejected the Desert Land applications to enter the subject lands. Thus, because of the failure to obtain a favorable classification, one of the conditions prescribed by Congress for the transfer of these particular lands from the public domain, appellees were not entitled to them.

Appellees sought to reverse the discretionary determination of the Secretary by obtaining a hearing or trial de novo. By claiming that they are entitled to a hearing and

that the Secretary has arbitrarily classified the land, they have sought and obtained a review to which they are not entitled. The classifications made by the Secretary here are clearly within the scope of the authority vested in him by the Taylor Grazing Act and were not in any sense arbitrary or capricious.

The grant of discretion to the Secretary to classify lands withdrawn by Executive Order No. 6910 is so clearly expressed in Section 7 of the Taylor Grazing Act, 43 U.S.C. sec. 315f, that it is difficult to see how any question about its existence can arise. The Secretary of the Interior has been "charged with the supervision of public business relating to * * * The public lands, * * *." R.S. sec. 441; 5 U.S.C. sec. 485. The Commissioner of the General Land Office, under the direction of the Secretary of the Interior, is directed to "perform all executive duties * * * in anywise respecting * * * public lands * * *." R.S. sec. 453; 43 U.S.C. sec. 2. He is expressly "authorized to enforce and carry into execution, by appropriate regulations,

every part of the provisions of * * * [the Title dealing with public lands] not otherwise provided for." R.S. sec. 2478; 43 U.S.C. sec. 1201.

The Supreme Court, in Cameron v. United States, 252 U.S. 450 (1920), at pages 459-460, stated the proposition that:

By general statutory provisions the execution of the laws regulating the acquisition of rights in the public lands and the general care of these lands is confided to the land department, as a special tribunal; and the Secretary of the Interior, as the head of the department, is charged with seeing that this authority is rightly exercised to the end that valid claims may be recognized, invalid ones eliminated, and the rights of the public preserved. Rev. Stats., §§ 441, 453, 2478; United States v. Schurz, 102 U.S. 378, 395; Lee v. Johnson, 116 U.S. 48, 52; Knight v. United States Land Association, 142 U.S. 161, 177, 181; Riverside Oil Co. v. Hitchcock, 190 U.S. 316.

See also Best v. Humboldt Mining Co., 371 U.S. 334, 337 (1963).

The authority given the Secretary of the Interior to supervise the administration and disposal of the public lands of the United States creates a special tribunal for this purpose, and may not be interfered with through mandamus or

injunction processes. United States ex rel. Riverside Oil Co. v. Hitchcock, 190 U.S. 316 (1903); United States ex rel. McBride v. Schurz, 102 U.S. 378 (1880); Brown v. Hitchcock, 173 U.S. 473 (1899); United States ex rel. Hall v. Payne, 254 U.S. 343 (1920).

In this case, the district court found the lack of a "fair hearing" by the Department of the Interior constituted an arbitrary and capricious act, requiring remand to that agency for the holding of a hearing (R. 154, 155). It is implicit in a discretionary matter that no hearing is required to be held. Jay v. Boyd, 351 U.S. 345 (1956); Shaughnessy v. Mezei, 345 U.S. 206 (1953); United States v. Nugent, 346 U.S. 1 (1953); Knauff v. Shaughnessy, 338 U.S. 537 (1950). The court's characterization of the administrative action as "arbitrary and capricious" adds nothing. It is merely another way of stating the court's conclusion that there must be an adversary hearing comparable to a legal trial. There is nothing to justify an attack on the administrative proceedings here, absent such an absolute requirement. Indeed, as noted later, there is nothing to indicate substantial prejudice to appellees because of lack of such a hearing.

The district court should have granted appellant's motion to dismiss, on the basis that this is a matter within the jurisdiction of the "special tribunal" concerning which the courts have only a limited function of review. "[S]o long as the legal title remains in the Government all questions of right should be solved by appeal to the land department and not to the courts." Brown v. Hitchcock, 173 U.S. 473, 477 (1899); Best v. Humboldt Mining Co., 371 U.S. 334, 338 (1963); Boesche v. Udall, 373 U.S. 472 (1963). This Court has long recognized the limited function of the courts in matters involving public lands. In Standard Oil Co. of California v. United States, 107 F.2d 402, 409-410 (1940), cert. den., 309 U.S. 654, this Court stated:

The disposal of the public lands is not a subject over which the "judicial power" of the United States is extended. It is a field in which the authority of the Congress is supreme. Lee v. Johnson, 116 U.S. 48, 6 S.Ct. 249, 29 L.Ed. 570; Art. IV, sec. 3, clause 2, of the Constitution, U.S.C.A.

The Supreme Court, in United States ex rel. Alaska Smokeless Coal Co. v. Lane, 250 U.S. 549 (1919), an analogous case, stated the rule (p. 555): "But where there is discretion,

* * *, even though its conclusion be disputable, it is impregnable to mandamus. [Citations omitted.]"

This Court, in Ferry v. Udall, 336 F.2d 706 (1964), in considering a question similar to that raised by this appeal, found that it lacked the power to review the Secretary's exercise of discretion. This Court held (pp. 711-712):

* * * The Isolated Tracts Act commits the decision to sell to the Secretary's discretion. Under the regulations adopted to administer the Act, the Secretary reserved the right to exercise that discretion any time before a bid had been accepted by the issuance of the cash certificate. Since section 10 of the Administrative Procedure Act prohibits judicial review of agency action "* * * by law committed to agency discretion * * *," we are without power to review the Secretary's decision in this case.

We recognize the intrinsic difficulty in determining whether a discretionary action of an agency is reviewable. Almost every agency action involves some degree of discretion of judgment. Yet it cannot be said that, for this reason, every agency action is unreviewable. Homovich v. Chapman, 89 U.S.App.D.C. 150, 153, 191 F.2d 761, 764. The analytical problem is that of determining when the agency action is "committed to agency discretion" within the meaning of section 10 of the Administrative Procedure Act, and when it merely "involves" discretion which is nevertheless reviewable. 4 Davis, Administrative Law Treatise § 28.16, pp. 80-81; Anno., Administrative Procedure Act, 97 L.Ed. 884, 889.

Our decision that the Secretary's decision is "committed" to his discretion is consistent with Panama Canal Co. v. Grace Line, Inc., 356 U.S. 309, 78 S.Ct. 752, 2 L.Ed.2d 788. There it was held that the courts could not review toll rates set by the Panama Canal Company because toll adjustments were a matter left to the discretion of the Company. It was determined that this decisional process was committed to the Company's discretion because it involved "* * * matters on which experts may disagree; they involve nice issues of judgment and choice, * * * which require the exercise of informed discretion." (356 U.S. at 317, 78 S.Ct. at 757, citations omitted) Similarly, a decision of whether or not it would be in keeping with sound policy to sell a particular parcel of land at a certain offered price involves the exercise of informed discretion.

See also LaRue v. Udall, 324 F.2d 428 (C.A. D.C. 1963), cert. den., 376 U.S. 907; United States v. Mackintosh, 85 Fed. 333, 336 (C.A. 8, 1898).

C. The Department of the Interior's interpretation and consistent application of a statute are entitled to great deference. - The Department of the Interior has long taken the consistent position that an application to enter public lands confers no absolute rights, where the allowance of such claim

is discretionary with the Secretary of the Interior, or classification of the land is a prerequisite to the allowance of an entry. Joseph E. Hatch, 55 I.D. 580 (1936); Lewis Lafon Gourley, A-28497 (November 6, 1961); Raymond L. Gunderson, 71 I.D. 477 (1964).

The weight that is given by courts to an interpretation of a statute by the Secretary of the Interior in the area of its expertise was stated repeatedly by the Supreme Court in Udall v. Tallman, 380 U.S. 1 (1965). That Court held at page 16:

When faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration.

In the Tallman case, the Supreme Court reversed a decision of a court of appeals which was premised on that court's different interpretation of an Executive Order than had been given to it by the Secretary of the Interior.

There can be no question but that the classification of public lands has been given to the Secretary of the Interior as a discretionary matter. Obviously it was never intended

by Congress that a hearing be held on a discretionary matter. "Where Congress intended a hearing to be held, it provided therefor in express terms, as it did in § 1 of the Taylor Grazing Act * * *." LaRue v. Udall, 324 F.2d 428, 432 (C.A.D.C. 1963).

The years of administrative practice within the Department of the Interior, all with congressional knowledge and approval, are entitled to great weight when the meaning of a statute is being considered by a court. From the fact that Congress has been aware of the broad classification powers being exercised by the Secretary and that it has not chosen to limit them in any way, we can infer that Congress deems the Secretary to be carrying out its intent. Brooks v. Dewar, 313 U.S. 354, 360-361 (1941); cf. United States v. Jackson, 280 U.S. 183, 196-197 (1930).

This case is in many ways analogous to Udall v. Tallman, 380 U.S. 1 (1965). In that case, the Secretary of the Interior was recognized as having complete discretion in determining whether lands were to be leased for oil and gas

development. In this case, the Secretary has the same absolute discretion as to how he will classify lands. In addition to stating that administrative interpretation of statutes must be given considerable weight, the court recognized that no hearing is required in determining whether lands would be made available for leasing.

D. The district court has erroneously assumed that the filing of an application to enter public lands has given the applicant a property right. - No rights to the land applied for are obtained by the filing of an application to enter. Only after the entry is allowed do any rights accrue. A preference right to enter the land is given an entryman if and when the land is favorably classified by the Secretary or his designated representative. No preference rights have accrued to the applicants in this case, since the land never was favorably classified. In this case, the lands applied for were found by the Secretary not to be suitable for desert land entry after a thorough and exhaustive analysis of the physical situations involved.

Since the applicants to enter public lands have no property right by virtue of having filed applications, there is absolutely nothing on which to base a due process of law argument. The district court posed the question to be determined as being "whether or not the plaintiffs were deprived of due process of law * * *" (R. 152). We submit that the applicants to enter public lands have not been deprived of a property right which would raise the due process question posed by the district court. A similar situation to this was presented in LaRue v. Udall, 324 F.2d 428, 432 (C.A.D.C. 1963), where a Fifth Amendment argument was advanced. There the court found that, since one of the provisions of the Taylor Grazing Act being dealt with provided that no rights were to be created by virtue of the operation of that section, no hearing was required in taking away grazing privileges. The result should be no different here. Only if the Secretary in the exercise of his discretion favorably classifies land, do rights accrue.

II

IN ANY EVENT, IT DOES NOT APPEAR
THAT THE LACK OF ADVERSARY HEARING
IN THE FIRST INSTANCE PREJUDICED APPELLEES

An examination of the administrative record shows that the appellees' written arguments and evidence have been thoroughly and carefully reviewed by the Department of the Interior at several levels. There is nothing arbitrary or capricious in the manner that the appellees' evidence, which they were permitted to submit, was treated by the Secretary. It would be difficult to find anywhere a more thorough consideration of the facts in this case than is contained in the Secretary's second decision rendered in this matter (R. 173-184). Appellees have no specific complaint as to facts not shown or as to arguments they were unable to make.

The classification question presented by the appellees' applications to enter was a question of fact, the decision of which by the Secretary of the Interior, or his authorized representative, is conclusive in the absence of fraud or imposition. Cameron v. United States, 252 U.S. 450, 459-461 (1920); Boesche v. Udall, 373 U.S. 472, 476-477 (1963); Best v. Humboldt Mining Co., 371 U.S. 334, 335-336 (1963).

The appellees were able to present all their evidence and views to the Secretary and his subordinate officials. Cf. The Dredge Corporation v. Penny (C.A. 9, No. 19964, May 23, 1966) ; Southwestern Petroleum Corp. v. Udall (C.A.10, No. 8250).^{3/} Nothing would have been gained by permitting the appellees to present this material orally or to cross-examine the Land Office technician who conducted experiments to ascertain the suitability of the land for agricultural uses. The only result would be delays and extended litigation. It was by design that Congress made this question of fact one to be determined by the exercise of discretion, rather than a matter to be resolved through litigation.

The question of whether or not a hearing was required involving another section of the Taylor Grazing Act was discussed at length in LaRue v. Udall, 324 F.2d 428 (C.A. D.C. 1963). There the court concluded at page 432 that: "Where Congress intended a hearing to be held, it provided therefor in express terms, as it did in § 1 of the Taylor Grazing Act

^{3/} Mimeographed copies of this unreported opinion are filed herewith.

(315 U.S.C. § 315)." The result in the present case should be no different than the result reached by the Court of Appeals for the District of Columbia Circuit.

The procedure followed here is not unique. The courts have held that offers to lease, i.e., applications, confer no rights to a lease but give only a priority to a lease if the Secretary, in his discretion, determines that a lease should issue. Haley v. Seaton, 281 F.2d 620 (C.A.D.C. 1960). Were a hearing required prior to every discretionary action being taken by the land office, delays would naturally follow which never were intended by Congress. It is the recognition of the possible delays and expense of hearings and appeals that Congress can and did see fit to dispose of the public lands through the statutes it enacted which give the Secretary of the Interior the discretion to act as he did in this case. The district court's judgment would convert general managerial decisions made in the course of administration of public lands (cf. Boesche v. Udall, 373 U.S. 472 (1963)) into individually litigated matters in every case. Such a serious impediment on management of the public lands is, we submit, plainly unwarranted.

III

THE EARLIER JUDGMENT
WAS RES ADJUDICATA

The appellees herein in both complaints filed in this controversy stated that "This action involves title to and right to possession of two parcels of certain public lands situate in the County of Kern, State of California." The first complaint stated that the action was brought under the Administrative Procedure Act. The second action was stated to arise under the Fifth Amendment of the United States Constitution. Both sought to restrain the appellant from taking any further action affecting the lands sought by the appellees and the reinstatement of their desert land applications. The first complaint also asked the court to adjudge the complained-of rejection to be arbitrary, capricious, discriminatory, unlawful and in excess of the statutory powers of the appellant. The relief asked for in both actions was identical, i.e., reversal of the Departmental decision. The only new element of the second complaint was as a somewhat different legal argument to justify the same result requested.

This Court in Hatchitt v. United States, 158 F.2d 754, 755 (1946), stated the rule as follows:

It is well settled that a valid and final judgment may be successfully pleaded in bar against any subsequent action between the same parties dealing with the same right as to the same res. That the muniment of right in each case is different does not militate against the application of the rule, so long as the general type of right in the identical res is the same.

This Court proceeded to develop the foundation for this rule by quoting from several Supreme Court cases as follows (pp. 755-756):

In the leading case of Northern Pacific R. v. Slaght, 205 U.S. 122, 130-132, 133, 27 S.Ct. 442, 445, 51 L.Ed. 738, the court said:

"The question as to such judgment when pleaded in bar of another action will be necessarily its legal identity with such action. The general rule of the extent of the bar is not only what was pleaded or litigated, but what could have been pleaded or litigated. There is a difference between the effect of a judgment as a bar against the prosecution of a second action for the same claim or demand, and its effect as an estoppel in another action between the same parties upon another claim or

demand [cases cited], and a distinction between personal actions and real actions is useful to observe. Herman, Estoppel, § 92. It is there said: 'Although there may be several different claims for the same thing, there can be only one right of property in it; therefore, when a cause of action has resulted in favor of the defendant, when the plaintiff claims the property of a certain thing there can be no other action maintained against the same party for the same property, for that would be to renew the question already decided; for the single question in litigation was whether the property belonged to the plaintiff or not; and it is of no importance that the plaintiff failed to set up all his rights upon which his cause of action could have been maintained; it is sufficient that it might have been litigated.'

"In United States v. California & Oregon Land Co., 192 U.S. 355, 24 S.Ct. 266, 48 L.Ed. 476, this principle was applied. In that case a decree rendered upon a bill in equity brought under an act of Congress to have patents for land declared void, as forfeited, and to establish the title of the United States to the land, was held to be a bar to a subsequent bill brought against the same defendants to recover the same

land, on the ground that it was excepted from the original grant as an Indian reservation. And, speaking of the two suits, we said, by Mr. Justice Holmes:

'The best that can be said, apart from the act just quoted, to distinguish the two suits, is that now the United States puts forward a new ground for its prayer. Formerly it sought to avoid the patents by way of forfeiture. Now it seeks the same conclusion by a different means; that is to say, by evidence that the lands originally were excepted from the grant. But in this, as in the former suit, it seeks to establish its own title to the fee.' And further: 'But the whole tendency of our decisions is to require a plaintiff to try his whole cause of action and his whole case at one time. He cannot even split up his claim [cases cited]; and, a fortiori, he cannot divide the grounds of recovery.'

* * * * *

"In other words, plaintiff in error; as successor of the Spokane & Palouse Railway Company, again asserts title to the very property that was the subject of the other suit, the source of title, only, being different. If this may be done, how often may it be repeated? If defeated upon the new title, may plaintiff in error assert still another one, either in its predecessor or in itself, and repeat as often as it may vary its claim?

The principle of res judicata and the cases enforcing and illustrating that principle declare otherwise." [Emphasis supplied.]

The general doctrine is stated in Stark v. Starr, 94 U.S. 477, 485 (1876):

It is undoubtedly a settled principle that a party seeking to enforce a claim, legal or equitable, must present to the court, either by the pleadings or proofs, or both, all the grounds upon which he expects a judgment in his favor. He is not at liberty to split up his demand and prosecute it by piecemeal, or present only a portion of the grounds upon which special relief is sought, and leave the rest to be presented in a second suit, if the first fail. There would be no end to litigation if such a practice were permissible.

In Williamson v. Columbia Gas & Electric Corp., 186 F.2d 464, 469-470 (C.A. 3, 1950), that court held:

The purpose of the principle of res judicata is to end litigation. The theory is that parties should not have to litigate issues which they have already litigated or had a reasonable opportunity to litigate. A reading of the early cases as compared with recent ones makes it clear that the meaning of "cause of action" for res judicata purposes is much broader today than it was earlier. Formerly the whole aim in pleading, and in the elaborate system of writs, was to frame one single legal issue. That being the

guiding principle, the phrase "cause of action" came to have a very narrow meaning. If the theory in the second suit was unavailable under the writ used in the first suit, the plaintiff had no opportunity to litigate it there and so plaintiff was not barred by *res judicata*. The force of the rule is still operative but the scope of its operation has been greatly limited by the modernization of our procedure. The principle which pervades the modern systems of pleading, especially the federal system, as exemplified by the free permissive joinder of claims, liberal amendment provisions, and compulsory counterclaims, is that the whole controversy between the parties may and often must be brought before the same court in the same action. The instant case presents an excellent example of one of the things these rules were designed to avoid. As pointed out above, the acts complained of and the demand for recovery are the same. The only thing that is different is the theory of recovery.

So here, the only new element introduced by appellees' second complaint was a legal argument based on alleged violation of due process. There is no exception from the rules of res adjudicata of alleged constitutional grounds. Thus, a decision as to just compensation under the Fifth Amendment is res adjudicata. Annat v. United States, 277 F.2d 554 (C.A. 5, 1960).

This Court in Myers v. Gardner (unreported, No. 20282, May 9, 1966) recently affirmed with approval the language of the district court where it had stated: "A judgment can only be collaterally attacked if it is obtained by extrinsic fraud or, probably, if there was a failure of due process. United States v. Throckmorton, 98 U.S. (8 Otto) 61 (1878)." The Supreme Court in United States v. Throckmorton, while not treating with due process, did consider an analogous situation. The Court at p. 68 stated:

* * * that the acts for which a court of equity will on account of fraud set aside or annul a judgment or decree, between the same parties, rendered by a court of competent jurisdiction, have relation to frauds, extrinsic or collateral, to the matter tried by the first court, and not to a fraud in the matter on which the decree was rendered.

Thus, the possible due process exception relates to defects in the court proceedings leading to the first judgment, not simply afterthought, as to the merits fairly adjudicated in the first case. We submit that appellees were entitled to attack the decision of the Department of the Interior only once, not twice, three times or interminably. They were obliged to present at the first judicial proceeding all of their objections to the administrative action.

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted,

EDWIN L. WEISL, JR.,
Assistant Attorney General.

MANUEL L. REAL,
United States Attorney,
Los Angeles, California, 90012.

RICHARD J. DAUBER,
Assistant United States Attorney,
Los Angeles, California, 90012.

ROGER P. MARQUIS,
GEORGE R. HYDE,
Attorneys, Department of Justice,
Washington, D. C., 20530.

JUNE, 1966

CERTIFICATE OF EXAMINATION OF RULES

I certify that I have examined the provisions of Rules 18 and 19, C.A. 9, and that in my opinion the tendered brief conforms to all requirements.

GEORGE R. HYDE
Attorney, Department of Justice
Washington, D. C., 20530

APPENDIX

IN THE UNITED STATES DISTRICT COURT
IN AND FOR THE SOUTHERN DISTRICT OF CALIFORNIA
NORTHERN DIVISION

LEONARD S. NOREN, HARRY C. PERRY,)	No. ND 2139 CIVIL
)	
Plaintiffs,)	
)	
vs.)	COMPLAINT
)	
WALTER E. BECK, as Manager of)	
the United States Land Office at)	
Sacramento, California, RAYMOND)	
R. BEST, as Regional Administra-)	
tor, Bureau of Land Management,)	
Department of the Interior,)	
)	
Defendants.)	
)	
)	

Plaintiffs complain of defendants and respectfully
represent to this Honorable Court:

I

This action is brought under the Administrative
Procedure Act (60 Stat. 243, enacted June 11, 1946) and
specifically under Section 10 of said Act (5 USCA 1009).
Jurisdiction is vested in this court by said statutes and by

28 USCA, Section 1392; the matter in controversy, as to each of the parcels of land hereinafter referred to, exceeds, exclusive of interest and costs, the sum of Ten Thousand Dollars (\$10,000.00).

II

Plaintiffs are residents of the County of Ventura, State of California, and are now and at all times herein mentioned have been citizens of the United States over the age of 21 years and are joined in this action because of the similarity of their cases.

III

Defendant WALTER E. BECK is the duly appointed, qualified and acting Manager of the United States Land Office, Department of the Interior, at Sacramento, California; defendant RAYMOND R. BEST is the duly appointed, qualified and acting Regional Administrator, Bureau of Land Management, Department of the Interior, stationed at Sacramento, California, and has some official duty and responsibility in the matters hereinafter referred to, the nature and extent of which are unknown to plaintiffs.

IV

This action involves title to and right to possession of two parcels of certain public lands situate in the County of Kern, State of California.

V

On November 26, 1951, plaintiff LEONARD E. NOREN filed in the United States Land Office at Sacramento, California his desert land application covering the S- $\frac{1}{2}$ of Section 22, Township 32 South, Range 26 East, Mount Diablo Base and Meridian in the County of Kern, State of California; that at the time of said filing said S- $\frac{1}{2}$ of said Section 22 was open public land and land, not timber or known mineral, which would not then and will not now, without irrigation, produce some agricultural crop; that said Land Office approved said application as to form and content and accepted the same together with the fee thereon required by law.

On January 3, 1952, plaintiff, HARRY C. PERRY, filed in the United States Land Office at Sacramento, California, his desert land application covering the SE- $\frac{1}{4}$ of Section 20, in the said Township and Range and in the County of Kern, State

of California; that at the time of filing said application, said SE- $\frac{1}{4}$ of said Section 20 was open public land and land, not timber or known mineral, which would not then and will not now, without irrigation, produce some agricultural crop; that said Land Office approved said application as to form and content, accepted the same together with the fee thereon required by law.

VI

That the manager of said Land Office, under the applicable rules and regulations of the Department of the Interior, is now and at all times herein mentioned was, authorized and empowered to allow or reject Desert Land Applications in accordance with the statutes in such case made and provided.

VII

That on January 9, 1953, the manager of said Land Office rejected plaintiffs' applications on the ground that the soil of both of the parcels of land applied for was unsuitable for agricultural development; that prior thereto, to wit: on June 15, 1951, said manager allowed the desert land application of one PETER A. LUPPEN covering land in the same township and range and adjacent to the lands covered by plaintiffs'

30

applications and in the same soil classification as the land included in plaintiffs' applications; that thereafter, to wit: on May 21, 1953 and within six months after his rejection of plaintiffs' applications the manager of said Land Office allowed the desert land application of one LYTTON F. IVANHOE, JR., covering land in the same township and range and in the same soil classification as the land covered in plaintiffs' applications; that neither of plaintiffs has ever been granted any hearing on his said application or on the rejection of the same.

VIII

That the action of said manager in rejecting plaintiffs' applications was as to each of them arbitrary, capricious, discriminatory, unlawful, illegal and a denial of rights accorded plaintiffs, and each of them, by the statute and constitution of the United States and particularly Section 7 48 Stat. 572 and 19 Stat. 327, in that the soil in the case of all four applications heretofore mentioned was and is of substantially the same type and character and in truth and in fact the land in each of the four applications for desert land entry heretofore mentioned was and is land,

not timber or known mineral, which by appropriate reclamation methods and with irrigation can be made to produce abundant agricultural crops of various kinds as shown by actual agricultural operations on land of substantially the same type and character in the immediate vicinity and in the same soil classification and by recognized agricultural tests.

IX

That plaintiffs upon said rejection of their said applications by said manager of said Land Office, appealed said rejection to the Director of the Bureau of Land Management, Department of the Interior, who affirmed the decision of the Director of the Bureau of Land Management and on October 15, 1960, denied plaintiffs' application for reconsideration of his said decision; that no further action is possible by plaintiffs in said Department of the Interior.

WHEREFORE, plaintiffs demand that it be adjudged and decreed:

1. That a temporary restraining order and preliminary injunction issue out of this court directing defendants and each of them and their subordinates and agents to refrain from any action affecting the status of the lands described herein pending further order of this court.
2. That it be adjudged and decreed that the rejection of plaintiffs' applications, and each of them, was arbitrary, capricious, discriminatory, unlawful and in excess of the statutory powers of defendants and that the same be set aside.
3. That defendants be required to reinstate the desert land applications of plaintiffs, and each of them, in the Sacramento Land Office, allow the same and authorize plaintiffs, and each of them, to enter the lands covered in their said applications as desert land entrymen all in the manner provided by law.

4. That plaintiffs have such other and further relief as to the Court may seem proper.

Dated at Fresno, California, this 14 day of December, 1960

CLAUDE L. ROWE and EDSON ABEL

By Claude L. Rowe
Attorneys for plaintiffs

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
NORTHERN DIVISION

LEONARD S. NOREN, HARRY C. PERRY,

Plaintiffs,

-vs-

WALTER E. BECK, as Manager of
the United States Land Office
at Sacramento, California,
et al.,

Defendants.

No. 2139-ND

MEMORANDUM AND ORDER

Filed March 8, 1963

This is an action to review the decision of the Bureau of Land Management, Department of Interior, denying plaintiffs' applications for entry upon certain lands in Kern County pursuant to the Desert Land Act (43 U.S.C. Sec. 321, et seq.)

From a decision of the Director of the Bureau of Land Management affirming the January 9, 1953 decision of the Manager of the Sacramento Land Office, which rejected plaintiffs' applications, plaintiffs appealed to the Secretary of the Interior. There the cases were remanded to the Bureau of Land

Management with instructions to allow plaintiffs a reasonable time in which to submit evidence to disprove classification of the lands as unsuitable for agricultural development and to reconsider the classification in the light of that and other pertinent evidence.

An important consideration in the Secretary's decision to remand the cases was the showing made that two applicants in the vicinity of the land desired by plaintiffs were apparently meeting with success in reclaiming their lands.

Further investigation showed that in one case a patent was granted only because of a technicality, and the actual fact was that there had been no success in reclaiming the land. In the other case, a relinquishment of the desert land entry was filed on September 9, 1959, after attempts to reclaim the land proved unsuccessful.

The results met in these two cases lend support to the determination made by the Department that the lands in question are not suitable for agricultural purposes. This determination was reached on the basis of examination of the

land by a field examiner, soil samples taken from the land and analyzed by chemists, and information contained in "Soils Survey Bakersfield Area, California," U.S.D.A. Bulletin No. 12.

Evidence from these sources show that the soils involved herein are of an excessive saline nature, unsuitable for agricultural purposes; that there is a lack of proper drainage; that the expense of adding gypsum to the land and providing proper drainage, which might make the lands usable for growing some crops, would be prohibitive in relation to the value of the lands.

Plaintiffs presented two affidavits by Orval Fillmore, a man with 35 years of experience in the planting, growing and culture of alfalfa, in which he describes two experiments wherein soils from the lands in question were removed to Ventura County and alfalfa planted in beds of the soil. He met with some apparent success.

These experiments were discounted by the Director of the Bureau of Land Management, however, because they showed nothing regarding drainage, a problem of importance in the determination of the land's unsuitability for agricultural

purposes. The Director again affirmed the decision of the Manager of the Land Office, and on appeal this decision was affirmed by the Secretary of the Interior on September 13, 1960.

Administrative remedies having been exhausted, the present action was commenced and the case was submitted upon the administrative record. This Court has previously held that the only evidence it may consider herein is the record made during the administrative proceedings in the Department of Interior, and the only question to be resolved is whether the decision of the Department of the Interior is supported by the evidence. See this Court's Opinion in the present case (Noren and Perry v. Beck, et al., 2139-ND), dated November 21, 1961, and the authorities cited therein.

Where the decision is supported by the record, it is conclusive, in the absence of fraud or imposition; and this Court cannot substitute its judgment for that of the Department. Ickes v. Underwood, 141 F.2d 546.

There has been no showing of fraud or imposition, and after a careful review I find that the administrative decision and the findings upon which it is based are abundantly supported by the evidence appearing in the record.

IT IS THEREFORE ORDERED that the decision of the Secretary of the Interior, dated September 13, 1960, is hereby affirmed.

IT IS FURTHER ORDERED that the Amended Complaint against defendants herein be, and the same is hereby, dismissed

Dated: March 8, 1963.

M. D. CROCKER
United States District Judge

No. 20671

In the
United States Court of Appeals
for the Ninth Circuit

ROBERT E. MCCARTHY, Successor to WALTER
E. BECK, as Manager of the United States
Land Office at Sacramento, California,
Appellant,

vs.

LEONARD E. NOREN and HARRY C. PERRY,
Appellees.

Appeal from the United States District Court for the
Southern District of California Northern Division

Brief for Appellees

EDSON ABEL

P.O. Box 396
Middletown, California

Attorney for Appellees

FILED

JUL 27 1966

WM. B. LUCK, CLERK

SUBJECT INDEX

	Page
Statement of the Case.....	1
Questions Presented	4
Summary of Argument.....	4
Argument	7
Introduction	7
A. The Order of Remand is not appealable as it lacks the necessary finality	8
B. The present action is against the appellant as manager of the United States Land Office at Sacramento, Cali- fornia. The Secretary of the Interior is not a party.....	12
C. The discretion at issue here is that exercised by the appellant and the exercise of that discretion in this case is reviewable, discriminatory, arbitrary and capricious....	13
D. Appellees acquired inchoate property rights by the filing of their Desert Land applications, property rights which were entitled to but were denied the protection of the due process provisions of the United States Constitution by appellant	17
1. Official discretion provided by the statute does not authorize a non-factual classification of lands applied for under public land laws.....	18
2. By filing Desert Land applications, and complying with other statutory requirements, appellees each ac- quired a property right.....	20
3. Appellees were entitled to a full constitutional hear- ing before they were deprived of their property rights	23
E. The present action is not subject to the plea of res judicata	26
F. Appellees sustained substantial injury from the uncon- stitutional, discriminatory, arbitrary and capricious re- jections of their applications.....	29
Conclusion	30

TABLE OF AUTHORITIES CITED

CASES	Pages
Adams v. Witmer, 271 F.2d 29.....	16, 23, 25, 30
Ballinger v. U.S., 216 U.S. 240, 30 S.Ct. 338.....	17
Burlington Truck Lines v. U.S., 371 U.S. 156.....	11
Cameron v. U.S., 252 U.S. 450.....	25
Dugan v. Rank, 372 U.S. 609.....	12, 13
Ferry v. Udall, 336 F.2d 706.....	14, 18
Ford Motor Co. v. NLRB, 305 U.S. 364.....	9, 11
Lawlor v. Nat. Screen Service Corp., 349 U.S. 322, 75 S.Ct. 865	28
Madera Irr. Dist. v. All Persons, 47 C.2d 681, 306 P.2d 886....	21
Morgan v. U.S., 304 U.S. 1, 58 S.Ct. 773.....	25
Noren v. Beck, 199 F.S. 708.....	6, 27
No. American Holding Corp. v. Murdock, 6 N.Y.2d 902 160 NE2d 926	11
Philadelphia Co. v. Securities & Exchange Comm., 84 App. D.C. 73, 175 F.2d 808.....	12
Rank v. Dugan, 293 F.2d 340.....	12
Securities Comm. v. Chenery Corp., 332 U.S. 194.....	11
Stark v. Starr, 94 U.S. 477, 24 L.Ed. 276.....	27
U.S. v. O'Leary, 63 I.D. 341.....	25
United States v. U.S. Smelting Co., 339 U.S. 186.....	11
U.S. v. Waddell, 112 U.S. 76, 5 S.Ct. 35.....	20
Wong Yang Sung v. McGrath, 339 U.S. 33, 70 S.Ct. 445....	23, 24, 25
Yuba River Power Co. v. Nevada Irr. Dist., 207 C. 521.....	21

STATUTES

Pages

Desert Land Act—43 U.S.C.A. 321 et seq.....	17
Taylor Grazing Act—43 U.S.C.A. 315 et seq.....	6
28 U.S.C.A. 1291	4
28 U.S.C.A. 1292	4
43 U.S.C.A. :	
315	18
315b	23
315f	17, 19
321	17, 22
322	20

MISCELLANEOUS

2 Am. Jur. 2d 671.....	11
42 Am. Jur. 191-192.....	20
2 Cal. Jur. 2d 377.....	16
43 C.F.R. 232.13.....	22
73 C.J.S. 691.....	22

No. 20671

In the
United States Court of Appeals
for the Ninth Circuit

ROBERT E. MCCARTHY, Successor to WALTER
E. BECK, as Manager of the United States
Land Office at Sacramento, California,

Appellant,

vs.

LEONARD E. NOREN and HARRY C. PERRY,

Appellees.

Appeal from the United States District Court for the
Southern District of California Northern Division

Brief for Appellees

STATEMENT OF THE CASE

This statement is included in the interests of clarity for the reason that the statement of appellant does not present the complete picture.

Appellees, citizen residents of Ventura County, State of California, filed separate Desert Land applications in 1951 and 1952 with the United States Land Office at Sacramento, California, the Noren application covering the S $\frac{1}{2}$ of Section 22 and the Perry application the SE $\frac{1}{4}$ of Section 20, both in Township 32 South, Range 26 East, M.D.B.&M., in

Kern County, California. The applications were made out on forms supplied by the Land Office and in accordance with its requirements and were accepted and filed by the Land Office upon the payment by appellees of the 25¢ per acre prescribed by the statute. (Complaint, R-3-4; Answer, R-99)

Thereafter, on January 9, 1953, and without any prior notice to appellees, both applications were rejected by the appellant on the alleged ground that the lands applied for were unsuited for agricultural development. (R-4) Appellant admits the filing of the applications and their rejections but denies approval of their form or their content. (R-100) No hearings of any kind were ever accorded either of the appellees prior to rejection of their applications.

Appellees appealed these rejections and pursued their administrative remedies without success until those remedies were exhausted in 1960. Appellees filed the present action alleging that the lands applied for were in truth and in fact suitable for agricultural purposes and that they had been deprived of their property rights in the lands applied for without a hearing in violation of the due process provisions of the United States Constitution. The complaint also alleges (R-5) discrimination in that similar Desert Land applications on nearby lands by other applicants were allowed by the same manager of the Sacramento Land Office in the same soil belt area covering lands with virtually identical soil constituency as those applied for by appellees and alleges that this discriminatory action was arbitrary and capricious. The complaint (R-6, 7) seeks judgment enjoining any further action adverse to appellees and requiring the setting aside of the rejections of their applications, the reinstatement of the same and their allowance.

The appellant is the present manager of the United States Land Office at Sacramento, California. It is alleged in the complaint (R-5) and admitted in the answer that the appellant is empowered under the law and the regulations to allow Desert Land applications. (R-4; R-100)

At the trial in the District Court, the Court received evidence on the questions of jurisdiction and any hearings accorded appellees before the rejection of their applications by appellant. The appellant introduced only the Administrative Record.

The necessary jurisdictional values were proved by appellees by photographic evidence of the excellent agricultural crops actually growing on acreages adjoining the lands in their applications and expert testimony as to the similar possibilities of the lands in question.

The District Court found that appellees by their applications as accepted by the Land Office at Sacramento had acquired property rights of which they had been deprived without due process and that they were entitled to a constitutional hearing on this question. With this finding, the Court discontinued the trial without touching the second cause of action in the complaint and remanded "the cause to the defendant (appellant) Robert E. McCarthy, as manager of the United States Land Office at Sacramento, California, and to the Bureau of Land Management of the United States Department of the Interior for the purpose of setting aside said rejections, and each of them, and conducting further hearings consistent with the findings of this Court." (R-155-6) These findings prescribed hearings at which appellees would have the right to present evidence, to be confronted with opposing evidence and to cross-examine opposing witnesses. (R-152-154)

Motion of the appellees to dismiss the appeal on the ground that the Order of Remand was not a final disposition of the issues was denied without comment by this Court on February 9, 1966.

QUESTIONS PRESENTED

1. Whether the Order of Remand from which this appeal was taken represented a final disposition of the issues in the case on their merits and is appealable.

2. Whether the statutory discretion given the Secretary of the Interior to classify lands is absolute and unreviewable.

3. Whether the appellees acquired property rights by the filing of their Desert Land applications of which they could not be deprived without a constitutional hearing.

4. Whether the appellant was guilty of abuse of discretion and violation of the constitutional rights of appellees in rejecting appellees' applications without affording them a constitutional hearing.

5. Whether the present action is subject to the plea of res judicata.

SUMMARY OF ARGUMENT

A. The authorities are virtually unanimous to the effect that an Order of Remand such as that from which this appeal was taken is not a final disposition of the issues of this matter on the merits. For this reason, there is lacking that finality required to make the Order appealable to this Court under 28 U.S.C.A. 1291. Obviously, the Order is not appealable under 28 U.S.C.A. 1292. The District Court, after proof of jurisdiction and lack of due process, discontinued the trial without touching the second cause of action and ordered the matter remanded to the appellant and the Bureau of Land Management, Department of the Interior,

for correction of the procedural errors. Under such circumstances, the Order of Remand is not a final disposition of the issues and therefore is not appealable.

B. This is an action against the manager of the United States Land Office at Sacramento, California, the appellant here and no one else. The complaint alleges (R-4) and the answer admits (R-99) that appellant in his capacity as manager of the United States Land Office at Sacramento, California, has the power to allow or reject Desert Land applications and thus is empowered to take corrective measures in this action. The Secretary of the Interior is not a party and his discretionary powers dwelt on at length in generalities by appellant are irrelevant except to the extent that such discretionary powers are also shared by appellant. The only questions here are whether appellees acquired property rights in filing their Desert Land applications, whether appellant failed in the necessary constitutional respect for any such property rights and whether appellant was guilty of abuse of discretion in disposing of their applications.

C. It is alleged in the complaint (R-5) that appellant allowed Desert Land entries on adjacent lands in the same identical soil belt which included the lands of appellees' rejected applications as determined by soil experts of the United States Department of Agriculture and the Experiment Station of the University of California. The statute makes classification mandatory on lands applied for under public land statutes and such classifications must be in accord with the facts without discretionary modification. The complaint alleges (R-5) that the classification by appellant of the lands sought by appellees was not only erroneous but also discriminatory, arbitrary and capricious. Where an Administrative agency acts arbitrarily, capriciously or

fraudulently, such action constitutes an abuse of discretion, and since it is unauthorized, it also is an excess of jurisdiction subject to correction by the Courts.

D. Under Sections 1 and 7 of the Taylor Grazing Act, as amended (43 U.S.C.A. 315, 315f) an applicant for Desert Land entry acquires an inchoate property right and the rules and regulations of the Department of the Interior formerly recognized the acquisition of such a right. The possessor of such a right is entitled to a full constitutional hearing before he can lawfully be deprived of that right. This sort of a hearing appellees did not have. The Department of the Interior is not the only Federal Administrative Agency which has had to abandon a traditional procedure of decisions emanating from a much censured prosecutor-judge arrangement in favor of a course of action affording an aggrieved party a real opportunity to be heard.

E. This action is not subject to the plea of *res judicata* for the simple reason that in case No. 2139 in the District Court the issues were confined to the Administrative Record at the instance of the appellant and the ruling of the Court. The constitutional and abuse of discretion issues in the second cause of action in the complaint were excluded from consideration by the successful motion of appellant and were not before the Court in No. 2139 as is clearly shown by the decision of the District Court as reported in *Noren v. Beck*, 199 F.S. 708, 709. The causes of action pleaded in this case (R-1-8) are entirely different from those cognizable within the confines of the Administrative Record and under the authorities are available in this present action.

F. Appellees sustained a substantial loss from the arbitrary and capricious rejections of their applications by appellant as the lands covered by their applications had genuine agricultural possibilities of real merit as has been

shown by subsequent developments in the area, developments photographically in evidence as Exhibits 5 and 6 before the District Court and on file in this Court. Furthermore, they were denied the valuable right of an opportunity to test the evidence against them by cross-examination and refutation prior to the decision.

ARGUMENT

Introduction

Appellant argues that administrative statutory construction of 29 years standing is in the balance in this appeal and that the decision of the District Court from which this appeal is taken would require a major change in procedure followed by the Department of the Interior. This is an exaggeration and somewhat inaccurate as will appear later. Apparently, the argument is that even the side-tracking of constitutional rights can improve with age. But the procedure attempted to be justified by appellant is a part of that administrative method widely condemned as combining in a single body the functions of prosecutor and judge. Congress was particularly critical of this arrangement where constitutional rights were involved.

The Department of the Interior has recognized for some time that on issues of property rights a hearing of some sort was mandatory as will be shown later. For many years it has conducted numerous hearings of this type, all within the family. Such hearings will be continued, it is to be presumed, under Administrative Procedure Act rules. How many more "adversary type" (a more descriptive word is "constitutional") hearings would result from requiring them in cases like the present is problematical. Appellant paints a gloomy picture on page 15 of his brief with a figure of 21,403 classifications pending in 1958. How-

ever, for purposes of this case, this total is to be discounted severely. There are a multitude of such classifications taking place continually where no contests occur. The significant figure would be the number of rejections of public land applications recorded during the year. Failure to produce this total suggests that it would not be too impressive. However, the question is of doubtful relevancy in cases in which constitutional rights are at stake.

A. The Order of Remand is not appealable as it lacks the necessary finality.

Appellees presented this contention to this Court by motion made on February 7, 1966, which was denied without comment. Appellees request the indulgence of the Court in the following more extensive review of the authorities on this point.

The Order of Remand here under appeal was made by the District Court without receiving any evidence on the second cause of action of the complaint. The Court gave advance notice to both parties on November 10, 1964, that in the event it was found that appellees had not been afforded due process, the Court intended "to return the case to the administrative agency for hearings." The Order of Remand rather obviously could not and did not attempt to make any disposition on the merits of the other issues in the case or reach any conclusions thereon. It is clear therefore, that there has been no final disposition of the issues at this time.

It will be noted that the Order of Remand required the appellant to set aside the rejections previously made by his predecessor and to hold further hearings consistent with the findings of the District Court which prescribed opportunity for appellees to know the evidence of the opposition,

to meet it and to cross-examine its witnesses and present evidence of their own. In other words, a new record would have to be made.

This required procedure is virtually identical with that before the United States Supreme Court in *Ford Motor Co. v. NLRB.*, 305 U.S. 364, a leading case, which was an appeal from an order of an Appeals Court remanding a cause to the National Labor Relations Board for the purpose of setting aside the findings of the Board assailed in the Court below and making a new record. The appellant in that case objected that the lower Court had not considered the merits of all of its criticisms of the original findings of the Board upon which it had based its petition for review. However, the Supreme Court said that these criticisms might be obviated in the new proceedings and ruled at p. 372:

“Second. The cause was remanded to the Board for the purpose ‘of setting aside its findings and order of December 22, 1937, and issuing proposed findings, and making its decision and order upon a reconsideration of the entire case.’ The Board in its application for the remand stated that it would take that course. The specified purpose qualified the court’s order. It created a condition which the Board was bound to observe. If the Board within a reasonable time failed to set aside its findings and order, we have no doubt that the court could vacate its order of remand and proceed with its consideration of the petition to review. The propriety of the order of remand must be considered in that aspect.”

What happened in that case corresponds rather exactly with what happened in the instant case. There the Appeals Court satisfied itself that there had been procedural errors

on the part of the National Labor Relations Board in its handling of the case before it and without going any further with the remaining issues it remanded the case to the Board for the purpose of "setting aside its findings and order * * *." Here as soon as the District Court received evidence satisfactorily establishing the absence of constitutional hearings before decision, it suspended further proceedings and remanded the matter to the appellant and the Bureau of Land Management for correction of the errors.

This seems to be the preferred method of handling situations of this kind as it allows the Administrative Agency to correct its own legal errors and avoids any possibility of encroachment by the judiciary on the administrative field.

It should be noted, however, that in the opinion of the Supreme Court there was no finality in this remand as the Appeals Court retained jurisdiction to vacate the order of remand in the event of failure on the part of the Administrative Agency to carry out instructions, an event which would allow the Appeals Court to "proceed with its consideration of the petition to review."

It seems obvious that if the reviewing court retained the power to vacate the order of remand, it also retained jurisdiction and the order of remand was not final. In the present case, there was no attempt by the reviewing court to make any final disposition of the issues. It merely found that appellees had been denied their right to a constitutional hearing in the preservation of their property rights and remanded the cause to the appellant as Land Office manager for correction of that omission. Any other objection to the previous procedure might well be corrected in the course of the new hearings which had been prescribed in the Order of Remand.

The *Ford Motor* case is a leading one on this point and is cited by the Supreme Court in its decisions in:

Securities Comm. v. Chenery Corp., 332 U.S. 194, 200 (1946)

United States v. U.S. Smelting Co., 339 U.S. 186, 198 (1949)

Burlington Truck Lines v. U.S., 371 U.S. 156, 172 (1962)

In considering the question of finality, 2 *Am. Jur.* 2d. under the subject "Administrative Law" had this to say at page 671:

"A remittitur for further action following annulment of an agency determination does not necessarily deprive the order of finality. If all that is left for the agency to do is ministerial, the order is final. If the agency has the power and duty to exercise residual discretion to take proof, or to make an independent record, its function remains quasi-judicial, and the order is not final."

The Order of Remand in this case cannot be complied with without the making of a new and independent record and under the foregoing statement of the law, the Order of Remand does not have the finality necessary to support this appeal.

The above summarization was followed in *No. American Holding Corp. v. Murdock*, 6 N.Y.2d 902, 160 N.E.2d 926, where the New York Court of Appeals ruled (1959):

"The Appellate Division, 6 A.D.2d 596, 180 N.Y.S. 2d 436, dismissed the appeal (from an order remitting a matter to the Board of Standards for further consideration) and held that in view of the fact that rehearing ordered involved the making of new and independent record, board would be required to exercise its judgment and discretion with respect to matters duly

presented to it or re-presented to it, and consequently the order was intermediate and not final, and an appeal therefrom did not lie. * * * *."

In *Philadelphia Co. v. Securities & Exchange Comm.*, 84 App. D.C. 73, 175 F.2d 808, the Court held that if an agency takes adjudicatory action without holding an adequate hearing, the merits of the action taken are not before the Court and the Court must remand the case with directions to the Commission to hold an adequate hearing.

These authorities clearly establish that the Order of Remand in this case was not a final disposition of the issues in the case on their merits and therefore is not an appealable order.

Without waiving the foregoing contention, appellees reply to other grounds advanced by appellant.

B. The present action is against the appellant as manager of the United States Land Office at Sacramento, California. The Secretary of the Interior is not a party and never was.

A large part of the brief of appellant is affected by a persistent misconception of the nature of this action. The Secretary of the Interior is constantly being injected into the situation when he is not a party to the action and never was. The true nature of this action was pointed out very clearly by the United States Supreme Court in *Dugan v. Rank*, 372 U.S. 609, 621, (considered in this Court in *Rank v. Dugan*, 293 F.2d 340) where in referring to the impounding of the San Joaquin River waters behind Friant Dam, the Supreme Court said:

"Nor do we believe that the action of the Reclamation Bureau officials falls within either of the recognized exceptions to the above general rule as reaffirmed only last Term. *Malone v. Bowdoin*, 369 U.S. 643. See *Larson v. Domestic & Foreign Corp.* supra (337 U.S.

682); *Santa Fe Pac. R. Co. v. Fall*, 259 U.S. 197, 199 (1922); *Scranton v. Wheeler*, 179 U.S. 141, 152-153, (1900). Those exceptions are (1) action by officers beyond their statutory powers and (2) *even though within the scope of their authority, the powers themselves or the manner in which they are exercised are constitutionally void*. *Malone v. Bowdoin*, supra, at 647. In either of such cases the officer's action 'can be made the basis of a suit for specific relief against the officer as an individual * * *.' *Ibid.*" * * * *

And the Court added:

"the action of an officer of the sovereign (be it holding, taking or otherwise legally affecting the plaintiff's property) can be regarded as so 'illegal' as to permit a suit for a specific relief against the officer as an individual only if it is not within the officer's statutory powers or, if *within those powers, only if the powers, or their exercise in the particular case, are constitutionally void*. *Id.* at 701-702." (Emphasis supplied)

In this particular case, it is alleged in the complaint (R-5-para. 9) that the exercise of appellant's power was constitutionally void in that appellees were deprived of their property rights by appellant's rejection of their applications without any hearing in a constitutional sense and without due process of law. This action therefore clearly comes within the purview of the Supreme Court's requirements in *Dugan v. Rank*, supra, and previous cases.

C. The discretion at issue here is that exercised by the appellant and the exercise of that discretion in this case is reviewable, discriminatory, arbitrary and capricious.

The Secretary of the Interior did not classify the lands in this case and is not a party to this action. The discretion at issue here is that exercised by the appellant and the

exercise of that discretion in this case is reviewable, discriminatory, arbitrary and capricious.

Two sentences in the appellant's brief may be said to epitomize this appellant's contentions with respect to official discretion in this action. They are:

p. 33 "In this case, the Secretary has the same absolute discretion as to how he will classify lands."

p. 34 "Only if the Secretary in the exercise of his discretion favorably classifies land, do rights accrue."

Appellant has reached these premises by confusing fact finding with managerial judgment. The contentions amount to a claim that if appellant declared unsuitable for agricultural development lands which were patently and demonstrably good farming land, his finding could not be questioned. Analysis of the cases cited by appellant shows that almost without exception, the decisions do not relate to the character of the land but to whether good management required its use for this purpose or that one. There was no necessity to determine the innate possibilities of the land itself. The case of *Ferry v. Udall*, 336 F.2d 706, is a good example of this difference. The decision left to the Secretary was whether the land should be sold or not. That was a matter of judgment and required no determination of any facts. The questions which the manager of the Sacramento Land Office had to decide was whether the lands sought by appellees met the statutory requirements for Desert Land entries. That was a question of fact which he answered one way in one instance and the opposite way in another instance with virtually the same set of facts. As this is a good example of how individual rights can be manhandled where official discretion is not supposed to be challenged, appellees cite their own case, evidence as to which is not of record for the reason that as soon as the lack of due process in the administrative procedure was

established, the District Court remanded the cause to the erring official for correction of the error. However, the complaint (R-5, para. 8) alleges the discrimination and the Transcript of Record (R-169) substantiates the facts given below.

So that there may be no misunderstanding as to the nature of the discrimination alleged by appellees, the following recital is inserted:

Appellees allege in Paragraph *VIII* of the first cause of action of their complaint (R-5) and repeated in the second cause of action (R-8) that lands covered in their rejected Desert Land applications and lands in Desert Land applications *allowed* by appellant were "nearby lands in the same identical soil belt as officially determined, classified and mapped by soil experts of the United States Department of Agriculture and the Agricultural Experiment Station of the University of California" and that the soils of the rejected and the allowed applications were substantially identical in their agricultural characteristics and possibilities.

Notwithstanding this fact, we have the following sequence of events all occurring in Township 32 South, Range 26 East, M.D.B.&M., in Kern County, California:

June 15, 1951.....	Luppen Desert Land Application allowed—Section 24 (R-169)
November 26, 1951	Noren Desert Land Application filed—Section 22 (R-3)
January 3, 1952.....	Perry Desert Land Application filed—Section 20 (R-4)
January 9, 1953.....	Noren and Perry Desert Land Applications rejected. (R-168) Soil unsuitable for agricultural development
May 21, 1953.....	Ivanhoe Desert Land Application allowed—Section 24 (R-169)

Summarizing, on June 15, 1951, the soil in question was suitable for agricultural development—In November, 1951, January, 1952 and on January 9, 1953, it was not and on May 21, 1953 it again became suitable for agricultural development. Truly a remarkable soil!

Where an administrative agency acts arbitrarily, capriciously, or fraudulently, such action constitutes an abuse of discretion, and, since it is unauthorized, an excess of jurisdiction subject to correction by the courts. Administrative determinations that violate constitutional rights by arbitrarily taking property or contravening procedural due process, although no element of fraud or bad faith is present, constitute abuses of discretion. Even determinations subject to only limited review will be rejected for fraud, bad faith, or such arbitrary and unreasonable action in wilful disregard of the law as amounts to constructive fraud. (2 Cal. Jur. 2d 377)

The argument of appellant here gives the impression that administrative discretion in cases of this kind is beyond review by the Courts. This Court in *Adams v. Witmer*, 271 F.2d 29, 33, thoroughly dispelled such an impression in the following language:

“Of course the officers of the Bureau of Land Management such as the appellee, Witmer, and those authorized within the Department to review his action, are authorized and required to exercise discretion in passing upon applications for patents to mining claims or upon contests with respect thereto. But this does not preclude judicial review within the meaning of the exception here involved. See *Homovich v. Chapman*, 89 U.S. App. D.C. 150, 191 F2d 761, 764. The exercise of discretion by the agency does not in itself negative the right to judicial review. In view of what the Supreme Court has said about judicial review in *Harmon v.*

Brucker, *supra*, and in the cases there cited, we cannot assume that the discretion granted the officials of the Bureau of Land Management to make decisions in these cases is an unreviewable one."

In the foregoing opinion, this Court cites the decision of the United States Supreme Court in *Ballinger v. United States ex rel Frost*, 216 U.S. 240, 248, 30 S. Ct. 338, 340, in which the Court affirmed the action of the lower court in reviewing and disapproving a decision of the Secretary of the Interior.

Applying appellant's argument to the present case, official discretion which reaches one decision on one set of facts and an exactly opposite decision on a second set of virtually identical facts cannot be questioned in the courts.

It should be pointed out that a careful reading of 43 U.S.C.A. 315f clearly indicates that the discretion there given the Secretary is to decide when to classify and when not to. There is no discretion on the classification itself. There was no compulsion to classify in the original statute but in the amendment in 1936, there was added the mandatory requirement to classify when an application under any public land law was filed. Here, again the *discretionary* authorization was absent.

D. Appellees acquired inchoate property rights by the filing of their Desert Land applications, property rights which were entitled to but were denied the protection of the due process provisions of the United States Constitution by appellant.

The filing of Desert Land applications by appellees under the provisions of 43 U.S.C.A. 321, et seq., and their acceptance by the appellant under the provisions of 43 U.S.C.A. 315f (Sec. 7 of the Taylor Grazing Act) created inchoate property rights in each of the appellees, rights which were

entitled to but were denied the protection of the due process provisions of the United States Constitution by the appellant.

1. Before proceeding with the specific argument under this heading, some observations should be made with respect to some of the assertions made in support of appellant's position which have a bearing on this phase of the controversy.

Comment has already been made concerning the effort to endow appellant with all of the discretionary powers of the Secretary of the Interior and to apply a plethora of generalities to this specific case. There has also been considerable labor devoted to the proposition that official discretion is present in all of the actions of the Secretary of the Interior. However, the statutory fabric does not have that much stretch in it. It is certainly true, as this Court held in *Ferry v. Udall*, 336 F.2d 706 (1964), that the Secretary is empowered under 43 U.S.C.A. 315, to use in some instances his uncontrolled discretion in making a policy decision. The latter would be a matter of judgment. The same can be said of the discretion given the Secretary in deciding *sponte sua* to classify lands. It was a policy matter entrusted to him and the Congressional colloquy quoted by the appellant on pages 18-21 of his brief shows it. However, in this connection, this excerpt from 43 U.S.C.A. 315, would appear to be controlling:

"Nothing in this chapter shall be construed in any way to diminish, restrict, or impair any right which has been heretofore or may be hereafter initiated under existing law validly affecting the public lands, * * * except as otherwise *expressly* provided in this chapter * * *." (Emphasis supplied)

It is apparent from this language that Congress was not mincing any words about preserving the rights customarily

associated with applications under the existing public land laws, one of which, of course was the Desert Land Act.

One might think from appellant's assertions that it was his contention that the Secretary's discretion was sufficiently all-pervasive to color the meaning of this excerpt. There has been some intimation that classification of lands was entirely subject to the Secretary's discretion but this has been negated by the language of the statute. Quoting from 43 U.S.C.A. 315f:

"Provided, that upon the application of any applicant qualified to make entry, selection, or location, under the public-land laws, filed in the land office of the proper district, the Secretary of the Interior *shall* cause any tract to be classified * * * *." (Emphasis supplied)

The mandatory "shall" relieves the Secretary of his usual discretion on whether or not to classify and attention should be called to the rather obvious proposition that when a classification occurs, it must be entirely on a *factual* basis, unmodified by Secretarial discretion.

Combining the Congressional intent evidenced in the two statutory excerpts just quoted, and considering it in the light of the construction which appellant contends applies to the Taylor Grazing Act, it is apparent that sufficient effect has not been given administratively to Congressional intent. It cannot be doubted that the administrators of the Taylor Grazing Act have so construed it as to "diminish, restrict" and "impair" the rights heretofore initiated under the Desert Land Act contrary to specific Congressional intent.

Appellees regard the discretion of the Secretary as of questionable relevancy in this case but have discussed it with the idea that some of it might have rubbed off on the

appellant. However, this action is against the appellant and the only relevant discretion is that which he exercised.

2. The authorities are agreed that what the appellees acquired by filing their Desert Land applications was a property right.

The procedure followed by appellees in the filing of their applications established inchoate property rights in each of them. They filled out form Desert Land entry blanks provided by the Sacramento Land Office in the manner prescribed by that Office. The completed and signed forms were tendered to the Land Office along with the 25¢ per acre required by the statute and both were accepted by the Land Office. It is rather obvious that they had each acquired a right to the lands described in their applications, subject only to defeasance in the event of an unfavorable classification. The Land Office had to make a classification and by such classification determine whether the land qualified as desert land under the definition of 43 U.S.C.A. 322, i.e. that it was land which would "not without irrigation, produce some agricultural crop" and if it did qualify as desert land it was suitable for the production of agricultural crops. Such a classification would have to be based on the actual character of the land and not on official discretion. Furthermore, it would have to be an honest classification.

With this resumé of the factual situation, attention is turned to the nature of a property right.

In *U.S. v. Waddell*, 112 U.S. 76, 80, 28 L.Ed. 673, 5 S. Ct. 35, it was held:

"By the original entry, he (entrant) acquires the inchoate right but well-defined right to the land * * *."

In 42 *Am. Jur.* pp. 191-192, it is said:

"It (the term 'property') extends to every species of right and interest capable of being enjoyed as such

upon which it is practicable to place a money value. As applied to lands, the term comprehends every species of title, inchoate or complete.”

In California recognized property rights are secured merely by filing applications to appropriate water. In *Yuba River Power Co. v. Nevada Irr. Dist.*, 207 C. 521, 523, one of the questions was whether a property right was acquired merely by filing such applications. The Supreme Court of California held that it was and defined “property” in the following language:

“The word ‘property’ found in this section (738 C.C.P.) is a broad term and is specifically defined in Sections 654 and 655 of the Civil Code. The word is also defined as follows: The term ‘property’ is sufficiently comprehensive to include every species of estate, real and personal, and everything which one person can own and transfer to another. It extends to every species of right and interest capable of being enjoyed as such upon which it is practicable to place a money value. As applied to lands the term comprehends every species of title, inchoate or complete. It is supposed to embrace those rights which lie in contract, those which are executory as well as those which are executed. (22 R.C.L. p. 43, Sec. 10).”

This view was confirmed in *Madera Irr. Dist. v. All Persons*, 47 C.2d 681, 690, 306 P.2d 886 (1957), where it was said with respect to a water right:

“Such right as was acquired was inchoate and incomplete and subject to defeasance upon the failure to perfect it in accordance with the law.”

The point to be stressed here is that the possibility of defeasance did not make it any less a right.

In 73 *C.J.S.* p. 691, it is stated:

“One who has made a legal entry on public land acquires an equitable title or equitable rights. * * * The equitable title cannot be divested without his consent. * * *.”

Finally, as late as December 31, 1961, the Bureau of Land Management in its Rules and Regulations relating to Desert Land entries (43 C.F.R. 232.13) provided as follows:

“(c) * * * no rights to the land are initiated by the filing of an application unless this sum (25¢ per acre) is paid or tendered).”

The 25¢ per acre is required by the statute (43 U.S.C.A. 321) and was paid by appellees when their applications were filed and the complaint (R-4) so alleges. The somewhat amusing fact is that while the present controversy was pending in the District Court, the Regulation just referred to was excised from the Revised Regulations. There may be some significance in the timing of this elimination but the fact is recorded to account for the absence of this particular provision from the current revision of the Department's Regulations. The Bureau of Land Management obviously recognized the initiation of rights by appellees by the filing of their applications and the contentions to the contrary by appellant now seem to be a little far-fetched. Certainly after fulfilling the statutory requirements, appellees acquired a status embodying substantial property rights.

Appellees must have secured some status by reason of their filings as accepted by appellant and it could not be other than by the acquisition of property rights. Congress by its language called it a preference *right* and it was, of course, subject to defeasance through an unfavorable classi-

fication. It was, however, a right to property, inchoate as it was. It is argued that no right was obtained and appellant attempts to subject it to the language in the last sentence of 43 U.S.C.A. 315b in which Congress provided that a *grazing permit* "shall not create any right, title, interest, or estate in or to the lands." No such prohibition was attached to the preference *right* and it is a fair inference that the omission was the result of deliberate intent on the part of Congress. This confirms the original interpretation of the Bureau of Land Management that a right was initiated by the filing of a Desert Land application and the payment of the 25¢ per acre as required by the statute.

3. With these property rights at stake, appellees are entitled to a full constitutional hearing before the rights can be taken from them. Whatever may have been the rule prior to the decision of the United States Supreme Court in *Wong Yang Sung v. McGrath*, 339 U.S. 33, 49, 70 S.Ct. 445, 454, 94 L.Ed. 616, and notwithstanding the absence of a statutory provision, it is now fully agreed that a full orthodox constitutional hearing is required. This Court in *Adams v. Witmer*, 271 F.2d 29, 33, stated the proposition as follows:

"* * * As the appellants' right to his mining claim was a property right, it follows that the requirements of due process necessitate that he have a hearing before he can be deprived of that property right. This constitutional requirement is no less mandatory than would be a mere statutory requirement for hearing. As stated in *Wong Yang Sung v. McGrath*, 339 U.S. 33, 49, 70 S.Ct. 445, 454, 94 L.Ed. 616, 'The constitutional requirement of procedural due process of law derives from the same sources as Congress' power to legislate and where applicable, permeates every valid enactment of that body.'"

In this phase of the controversy, appellant has contented himself with a bare statement that no rights were acquired by appellees but in this instance appellees believe that great deference should be paid to the rule of the Department of the Interior when the applications were filed and thereafter at least until January 1, 1962, to the effect that upon payment of the statutory 25¢ per acre, rights were initiated and the only rights which could have been intended in such a case were property rights.

Appellant claims that the procedures regulating the handling of public lands under the Taylor Grazing Act have been in effect for 29 years and that they are geared to Congressional intent. Such an intent is drawn, as usual, from Congressional language in the statute and at times from Congressional hearings. However, it is submitted that procedures in many administrative agencies have been changed by the decision of the United States Supreme Court in *Wong Yang Sung v. McGrath*, supra, (1949) which read into many statutes a hearing requirement never before recognized. The basis for this radical change was as stated by the Supreme Court:

“But the difficulty with any argument premised on the proposition that the deportation statute does not require a hearing is that, without such hearing, there would be no constitutional authority for deportation. The constitutional requirement of procedural due process of law derives from the same source as Congress’ power to legislate and, where applicable, permeates every valid enactment of that body. * * * *

“When the Constitution requires a hearing, it requires a fair one, one before a tribunal which meets at least currently prevailing standards of impartiality. * * * *

“It might be difficult to justify as measuring up to constitutional standards of impartiality a hearing tribunal for deportation proceedings the like of which

has been condemned by Congress as unfair even where less vital matters of property rights are at stake."

In *Morgan v. U.S.*, 304 U.S. 1, 18, 58 S.Ct. 773, 776, the ingredients of a fair hearing were given in some detail:

"The right to a hearing embraces not only the right to present evidence, but also a reasonable opportunity to know the claims of the opposing party and to meet them."

A hearing requirement has been thus read into the Immigration Statute and, since the *Wong Yang Sung* case, into several other statutes, including those administered by the Department of the Interior. In *U.S. v. O'Leary*, 63 I.D. 341, 344 and 345, that Department itself ruled that in its administration of the public lands hearings under the Administrative Procedure Act were necessary in cases involving property rights despite absence of statutory provisions requiring them, using the following reasoning:

"Inasmuch as a mining claim is a property claim which may not be invalidated without due process of law, hearings on the validity of such claims seem clearly to be within the scope of the court decisions referred to above holding that administrative proceedings in which a hearing is necessary in order to satisfy the requirements of due process must comply with the Administrative Procedure Act, even though there is no statute requiring that the matter be determined on the record after opportunity for agency hearing."

This Court commented on this Department ruling in *Adams v. Witmer*, 271 F.2d, *supra*, at page 33.

In the ruling, the Department included the following citation from *Cameron v. United States*, 252 U.S. 450, 460, 461, which contains some pronouncements applicable to this case:

“Of course, the land department has no power to strike down any claim arbitrarily, but so long as the legal title remains in the Government it does have the power, after proper notice and upon adequate hearing, to determine whether the claim is valid and, if it be found invalid to declare it null and void. This is well illustrated in *Orchard v. Alexander*, 157 U.S. 372, 383, where * * * this court said: ‘The party who makes proofs, which are accepted by the local land officers, and pays his money for the land, has acquired an interest of which he cannot be arbitrarily dispossessed. His interest is subject to state taxation * * * The Government holds the legal title in trust for him, and he may not be dispossessed of his equitable rights without due process of law. Due process in such cases implies notice and a hearing. But this does not require that the hearing must be in the courts, or forbid an inquiry and determination in the Land Department.’ ”

In the instant case, appellees filed Desert Land applications with the Sacramento Land Office made out on forms supplied by that office and completed in a manner satisfactory to the Land Office and accepted by it. They paid the money specified in the statute and despite this compliance with the foregoing Supreme Court ruling, appellant contends they acquired not an iota of a right.

E. The present action is not subject to the plea of *res judicata*.

Appellant attaches to his brief a copy of the complaint in Case No. 2139-ND filed by appellees in the District Court and a copy of the Court’s Memorandum and Order in that case dated March 8, 1963, and argues that the language of this complaint proves that the issues in the present case had been decided in Case No. 2139. This is completely misleading and if the appellant had wanted to be fair with the Court and the appellees, he would also have attached

a copy of his successful motion to confine that case to the Administrative Record and at least refer to the reported decision in the No. 2139 case of *Noren v. Beck*, 199 F.S. 708, in which the Court in its final judgment clearly shows that its consideration did not go beyond the Administrative Record.

In his attempt to establish his point of *res judicata*, appellant, among other authorities, cites and relies on *Stark v. Starr*, 94 U.S. 477, 485, 24 L.Ed. 276, 278. That case provides not only the general rule but also an exception to it. Appellant excerpted the statement of the general rule as follows:

“It is undoubtedly a settled principle that a party seeking to enforce a claim, legal or equitable, must present to the Court, either by the pleadings or proofs, or both, all the grounds upon which he expects a judgment in his favor.”

However, the Court went on:

“But this principle does not require distinct causes of action—that is to say, distinct matters,—each of which would authorize by itself independent relief, to be presented in a single suit, though they exist at the same time and might be considered together. * * * There was, therefore, no rule of law which compelled the presentation of the two causes of relief in the same suit. They required different allegations, in the bill, and different evidence on the hearing.”

and proceeding further, the Court said on p. 486:

“Having required the complainants to proceed in that suit only upon one cause or ground for relief, the court left the other cause open for any future suit which they might choose to bring.”

This decision is particularly appropriate in the present instance as in Case No. 2139 in the District Court the

appellant forced the appellees to proceed only on the Administrative Record and successfully resisted amendments to bring in the issues raised in the present case. If the complaint in No. 2139 is appraised divested of the allegations which became irrelevant under the Order limiting consideration of it to the Administrative Record, the difference between it and the complaint in No. 2347 becomes extremely evident. In the latter case, much more would be decided than could have been adjudicated in 2139; 2347 embraces more subject matter than 2139. Consistent with the successful motion of appellants, the issue of discrimination could not be litigated in 2139; the question of denial of due process raised in 2347 could not be considered in 2139; additional facts not relevant in 2139 can be introduced in 2347; different rights are asserted in 2347 which could not be claimed in 2139. The bases of the action in 2347 will require different evidence on the hearing.

In the comparatively recent case of *Lawlor v. Nat. Screen Service Corp.* (1955), 349 U.S. 322, 326, 327, 75 S.Ct. 865, 99 L.Ed. 1122, the United States Supreme Court had occasion to deal with a plea of *res judicata*. It said:

“Thus, under the doctrine of *res judicata*, a judgment on the merits in a prior suit involving the same parties or their privies bars a second suit *based on the same cause of action*.”

and went on:

“That both suits involved ‘essentially the same course of wrongful conduct’ is not decisive.” (Emphasis Supplied)

In the instant case, the causes of action were entirely different from that disposed of in No. 2139 and had been excluded from consideration in that case. The issues in the instant case are having their first day in Court.

Thus, where there is a distinctly different cause of action involved, the doctrine of *res judicata* does not apply, particularly when appellant, with the approval of the Court, prevented the earlier litigation of the different cause of action.

F. Appellees sustained substantial injury from the unconstitutional, discriminatory, arbitrary and capricious rejections of their applications.

Appellant naively suggests that appellees have suffered no damage from the rejections of their applications because *thereafter* they were allowed to file written statements, affidavits and a few photographs. While appellees availed themselves of this privilege, the deed was already on the record and the decision would stand or fall on whatever facts were on record before it was rendered. Furthermore, throughout the administrative process appellees were faced with the same combined prosecutor-judge arrangement which has been widely condemned for its lack of fairness and impartiality.

Appellees contend that with a constitutional, fair and impartial treatment of their applications without discrimination, those applications would have been allowed and appellees would now be in possession of lands with genuine agricultural possibilities of real merit as has been shown by subsequent developments in the adjoining areas, developments photographically in evidence as Exhibits 5 and 6 before the District Court and on file in this Court as a part of the Record on Appeal.

Appellant argues that appellees were not harmed by their treatment inasmuch as they were allowed to file all the evidence they desired with the Land Office at Sacramento, California. The best answer to this argument and a complete

one, it seems, is supplied by this Court in its decision in *Adams v. Witmer*, 271 F.2d 29, 36, where it was pointed out:

“As a result there is no chance for appellant to have a decision based on the possibly greater credibility of its witnesses as against those for the Government. The opportunity to have that kind of hearing is a valuable right.”

No such hearing, or even anything resembling it, was ever accorded appellees. So far as the evidence used by the Government in this instance is concerned, the first time appellees were ever aware of it was when they read the decision using it. They never had a reasonable opportunity to know this evidence or to meet it before it was used against them.

CONCLUSION

The appeal from the Order of Remand should be dismissed as that action of the District Court was not a final disposition of the issues in the case on their merits. Appellant speaks of reversing the judgment. There has been no judgment and none is before this Court.

Respectfully submitted,

EDSON ABEL

Attorney for Appellees

July, 1966

Certificate of Compliance with Rules

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

EDSON ABEL

Attorney for Appellees

No. 20671

In the

United States Court of Appeals

For the Ninth Circuit

ROBERT E. MCCARTHY, Successor to WALTER
E. BECK, as Manager of the United States
Land Office at Sacramento, California,
Appellant,

vs.

LEONARD E. NOREN and HARRY C. PERRY,
Appellees.

Appeal from the United States District Court for the
Southern District of California, Northern Division

Petition for Rehearing

EDSON ABEL

P.O. Box 396
Middletown, California

Attorney for Appellees

FILED

DEC 6 1936

U.S. DIST. COURT

TABLE OF AUTHORITIES CITED

CASES	Pages
American S. & R. Co. v. Maloy, 199 F.2d 52.....	3
Carter v. Powell, 104 F.2d 428, certiorari denied 308 U.S. 611	2
Clark v. Paul Gray, Inc., 306 U.S. 583.....	4
Cover v. Schwartz, 133 F.2d 541.....	2, 4
Donovan v. Esso Shipping Co., 259 F.2d 65, certiorari denied, 359 U.S. 907.....	2, 3
Ford Motor Co. v. NLRB, 305 U.S. 364.....	3
Gannon v. American Airlines, Inc., 251 F.2d 476.....	2, 3
Matson Nav. Co. v. U. S., 284 U.S. 352, 76 L.Ed. 336.....	4
No. Amer. Holding Corp. v. Murdock, 6 N.Y.2d 902, 160 N.E. 2d 926 (1959)	3
Philadelphia Co. v. S. & E. Comm., 84 App. D.C. 73, 175 F.2d 808	3
Stone v. Wyoming Supreme Court, 236 F.2d 275.....	2
Yoder v. Nutrena Mills Inc., 294 F.2d 505.....	3
STATUTE	
28 U.S.C., Section 1292.....	2
TEXTS	
Nichols Cyc. Fed. Proc. (3d Ed.), Sec. 60.94.....	2
2 Am. Jur. 2d p. 671.....	3

No. 20671

In the

United States Court of Appeals

For the Ninth Circuit

ROBERT E. MCCARTHY, Successor to WALTER
E. BECK, as Manager of the United States
Land Office at Sacramento, California,

Appellant,

vs.

LEONARD E. NOREN and HARRY C. PERRY,

Appellees.

Appeal from the United States District Court for the
Southern District of California, Northern Division

Petition for Rehearing

*To the Honorable Judges of the United States Court of
Appeals for the Ninth Circuit:*

Petitioners, appellees herein, respectfully request a rehearing in the above-entitled cause and pray that the Decision herein dated November 8, 1966, be modified and reversed as hereinafter specified and that the appeal herein be dismissed for the reasons and upon the grounds following, to wit:

The Decision of This Court Herein Is Void for Want of Jurisdiction.

(a) The Decision in its entirety is in excess of the jurisdiction of this Court as the Notice of Appeal (R-162) initiating this matter before this Court designates *only* the lower Court's Order of Remand to the Administrative Agency. It reads in part: "the defendants * * * hereby appeal to the United States Court of Appeals for the Ninth Circuit from the Order of Remand, entered herein September 17, 1965." Nothing else is designated and it follows that this Court's jurisdiction to review is limited to consideration of the Order of Remand exclusively.

Carter v. Powell, 104 F.2d 428, certiorari denied 308 U.S. 611;

Stone v. Wyoming Supreme Court, 236 F.2d 275;

Gannon v. American Airlines, Inc., 251 F.2d 476, 482;

Cover v. Schwartz, 133 F.2d 541, 546;

Donovan v. Esso Shipping Co., 259 F.2d 65, 68, certiorari denied, 359 U.S. 907;

Nichols Cyc. Fed. Proc. (3d Ed.), Sec. 60.94.

The Notice of Appeal in this instance is definite, specific, certain and unambiguous and has no covert elements serving, lawfully or otherwise, as an avenue for the introduction into this proceeding of matters not within the limited jurisdiction of this Court.

(b) While the Order of Remand is the only action of the District Court designated in the Notice of Appeal, for some reason not apparent, it is not given *any* consideration in the Decision herein.

(c) The Order of Remand to the Administrative Agency in this instance is not within this Court's jurisdiction as it is not an appealable Order under either Section 1291 or Section 1292 of 28 U.S.C. It is not appealable as it is not a

final Order. It merely returns the matter to the Administrative Agency for further hearings, the correction of procedural errors and the making of a new record.

2 Am. Jur. 2d p. 671;

Philadelphia Co. v. S. & E. Comm., 84 App. D.C. 73, 175 F.2d 808;

No. Amer. Holding Corp. v. Murdock, 6 N.Y.2d 902, 160 N.E. 2d 926 (1959).

(d) An Order remanding a matter to an Administrative Agency for the correction of procedural errors is not a final Order.

Ford Motor Co. v. NLRB, 305 U.S. 364, 372.

This decision of the United States Supreme Court involved facts *identical* with those in the instant case and no cogent reasons appear herein to justify rejection of the Supreme Court's appraisal of the procedural situation in the case just cited.

(e) Any Decision rendered or Order entered by a Court in a matter which is in excess of its jurisdiction is a nullity and void.

Yoder v. Nutrena Mills Inc., 294 F.2d 505;

Gannon v. American Airlines, Inc., 251 F.2d 476, 482;

American S. & R. Co. v. Maloy, 199 F.2d 52;

Donovan v. Esso Shipping Co., 259 F.2d 65, 68, certiorari denied, 359 U.S. 907.

(f) A jurisdictional objection may be lodged at any time including for the first time on appeal. Jurisdiction of the subject matter in any proceeding is conferred by law and cannot be given, enlarged or waived by the parties. When want of jurisdiction appears, (whether initially or on appeal) a court must dismiss.

Matson Nav. Co. v. U. S., 284 U.S. 352, 359, 76 L. Ed. 336, 359;

Clark v. Paul Gray, Inc., 306 U.S. 583;

Cover v. Schwartz, 133 F.2d 541, 546.

Respectfully submitted,

EDSON ABEL

Attorney for Appellees

December, 1966

Certificate of Compliance with Rule 23

I hereby certify that I have examined the foregoing petition and that in my opinion it is well founded and entitled to favorable consideration of the Court and that it is not filed for the purpose of delay.

EDSON ABEL

Attorney for Appellees

